

THE CPAP STUDY GUIDE TO VCE ACCOUNTING



6th edition
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UNIT 3: FINANCIAL ACCOUNTING FOR A TRADING BUSINESS

This unit focuses on financial accounting for a trading business owned by a sole proprietor, and highlights the role of accounting as an information system. Students use the double entry system of recording financial data and prepare reports using the accrual basis of accounting and the perpetual method of inventory recording.

Students develop their understanding of the accounting processes for recording and reporting, and consider the effects of decisions made on the performance of the business. They interpret reports and information presented in a variety of formats and suggest strategies to the owner to improve the performance of the business.

Where appropriate, the accounting procedures developed in each area of study should incorporate the application of the Conceptual Framework, financial indicators to measure business performance, as well as the ethical considerations, including financial, social and environmental considerations, faced by business owners when making business decisions.

A 1

In this area of study, students focus on identifying and recording financial data for a business. They use double entry accounting to record data and generate accounting information in the form of accounting reports and graphical representations. This information is used to assist the owner in making informed decisions about the operation of the business. Students should also consider strategies to improve the performance of the business, taking into account the relevant ethical considerations.

Outcome 1

On completion of this unit the student should be able to record financial data using a double entry system; explain the role of the General Journal, General Ledger and inventory cards in the recording process; and describe, discuss and analyse various aspects of accounting reports and the accounting system, including ethical considerations.

To achieve this outcome the student will draw on key knowledge and key skills outlined in Area of Study 1.

Key knowledge

- the accounting assumptions and qualitative characteristics, as applicable
- documents used by a business to record financial transactions
- the accounting elements: assets, liabilities, owner's equity, revenues and expenses
- the classification of assets and liabilities into categories of current and non-current
- the effects of transactions on the accounting equation
- the characteristics of the General Ledger with T-form accounts for manual recording
- the GST Clearing account
- the General Journal and General Ledger and their use in recording transactions, both manually and using ICT, including:
 - establishment of a double entry system
 - cash payments (GST on settlement discounts excluded)
 - cash receipts (GST on settlement discounts excluded)
 - credit sales of inventory
 - credit purchases of inventory
 - Sales Returns from accounts receivable
 - Purchase Returns to accounts payable
 - inventory write-down
 - inventory loss or gain
 - correction of errors
 - inventory used for advertising purposes (GST excluded)
 - drawings of inventory by the owner (GST excluded)
 - contribution of non-current assets at fair value by the owner
- the purpose and preparation of the use of the Trial Balance
- inventory cards using the First-In, First-Out (FIFO) and Identified Cost methods for:
 - inventory sold
 - inventory purchased
 - inventory returned
 - drawings of inventory by the owner
 - inventory used for advertising
 - inventory loss or gain

- inventory write-down
- inventory valuation
 - product and period costs
 - the lower of cost and net realisable value (NRV)
- the creation of an allowance for doubtful debts using the Income Statement approach
- the writing-off of bad debts using the allowance method in the subsequent period
- internal control procedures to safeguard resources against theft and fraud
- financial indicators: inventory turnover, accounts payable turnover, accounts receivable turnover
- non-financial information available to assist analysis and decision-making in relation to inventory, accounts receivable and accounts payable
- strategies to improve the management of inventory, accounts receivable and accounts payable
- ethical considerations when making business decisions in relation to operating a trading business

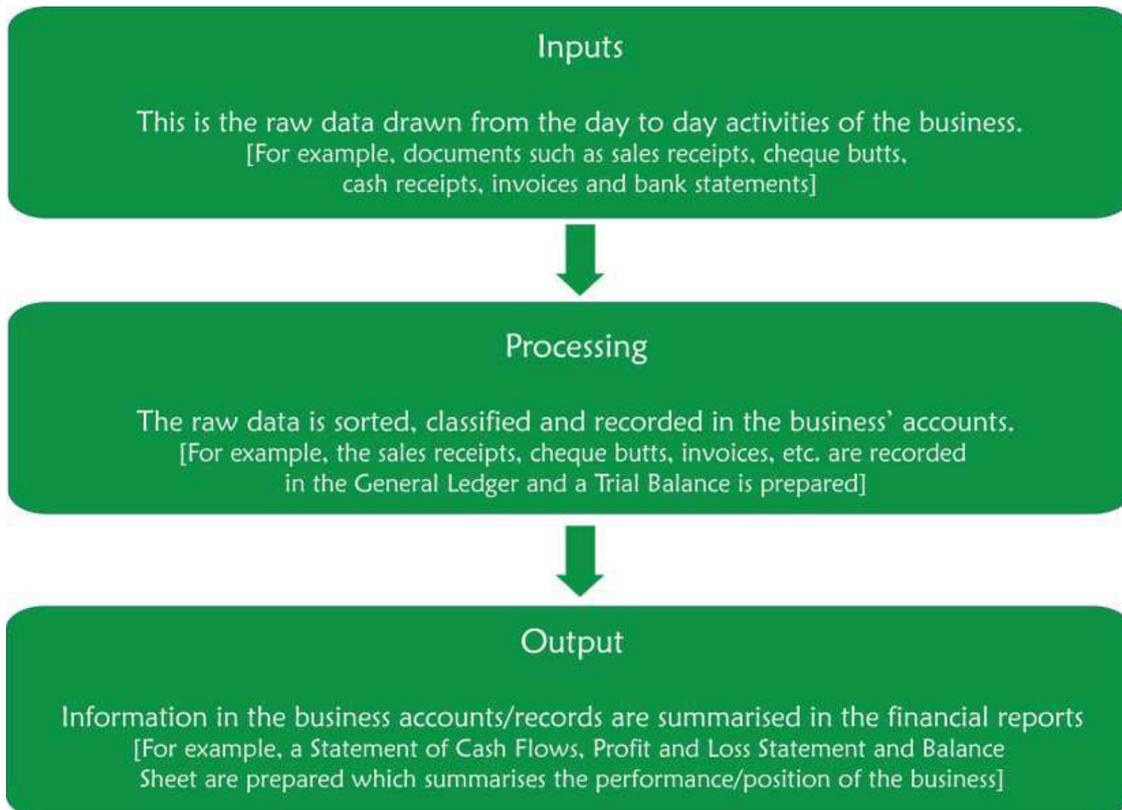
Key skills

- use correct accounting terminology
- explain and apply relevant qualitative characteristics and accounting assumptions
- apply theoretical knowledge to simulated situations
- identify and manually record financial data in the General Journal, General Ledger and inventory cards
- use ICT to record financial data in the General Journal, General Ledger and inventory cards and to construct graphical representations
- distinguish between current and non-current assets, and current and non-current liabilities
- explain the purpose of a Trial Balance
- explain and apply appropriate internal control procedures
- analyse the effects of transactions on the accounting equation
- distinguish between product and period costs in relation to inventory valuation
- use ICT, including spreadsheets, to model and analyse the effects of alternative inventory valuation methods and cost assignment methods
- evaluate the effects of alternative inventory valuation methods and cost assignment methods on the accounting equation
- model and analyse the financial effects of alternative strategies to improve business performance
- discuss strategies to improve the management of inventory, accounts receivable and accounts payable
- discuss ethical considerations involved in decisions made by owners of trading businesses

WHAT IS

As noted in the VCE Accounting Study Design, Accounting involves modelling and forecasting financial information, such as sales and profit figures, and using that information to provide advice to stakeholders, such as shareholders and lenders. The modelling, forecasting and advice is conducted or enabled via the process of collecting, recording, reporting, analysing and interpreting financial and non-financial data and accounting information. This information, once communicated to internal stakeholders (e.g. managers) and external stakeholders (e.g. shareholders), is designed to improve both the decision-making and improve performance of the business. It is in this respect that Accounting plays an integral role in the successful operation and management of businesses.

In a nutshell, Accounting is a process involving the recording and reporting of financial information to allow users of this information to make decisions. This process consists of three important stages – Inputs, Processing and Output.



As outlined on page 4, Unit 3 focuses on financial accounting for a trading business owned by a sole proprietor. It highlights the role of accounting as an information system, where students are taught to use the double entry system of recording financial data, as well as prepare reports using the accrual basis of accounting and the perpetual method of inventory recording.

Over the course of Unit 3, students will record and report financial information and consider the effect of business decisions on the overall performance of the business. Students will be then be required to interpret reports and other information and suggest strategies that are designed to improve the performance of the business.

Area of Study 1 focuses on identifying and recording financial data for a business using double entry accounting to record data and generate accounting information (e.g. accounting reports and graphical representations), while Area of Study 2 focuses on the preparation of financial reports and providing information that can be used as a basis for planning and decision-making by the owner. It will necessarily include an analysis of accounting reports and the interpretation of these reports (and other information) in order to evaluate the performance of the business.

ACCOUNTING ASSUMPTIONS AND QUALITATIVE CHARACTERISTICS

ACCOUNTING ASSUMPTIONS

Accounting assumptions are the basis of the preparation and presentation of financial statements.

Accounting Entity Assumption	The records of assets, liabilities and business activities of the entity are kept completely separate from those of the owner.
Accrual Basis Assumption	Under the accrual basis of accounting, revenue is recognised when it is earned and expenses recognised when they are incurred. Profit for a period is determined by subtracting expenses incurred for a period from revenue earned in that same period.
Going Concern Assumption	Financial reports are prepared on the assumption that the existing entity will continue to operate into the future.
Period Assumption	Reports are prepared for a particular period of time, such as a month or a year, in order to obtain comparability of results.

QUALITATIVE CHARACTERISTICS

Qualitative characteristics are what makes information in financial statements useful to users.

Relevance	Relevant information is capable of making a difference to the decisions made by users.
Faithful representation	The information reported is complete, free from error and without bias.
Comparability	Comparability enables users to identify and understand similarities and differences in the information about an entity from another period.
Verifiability	The information reported will mean that all users will reach the same conclusion. An event will be faithfully represented when it can be verified by source documents and checked through the auditing process.
Timeliness	Timeliness means having information available to decision-makers in time to be capable of influencing their decisions.
Understandability	The information reported is presented clearly and concisely to be understood by users with reasonable knowledge of business activities.

Exam Tip: A useful way to prepare for assessment tasks and exams is to create study cards for key definitions or concepts. Purchase those white, lined cardboard cards from Officeworks. On one side, write the accounting assumption, qualitative characteristic, type of transaction or name of General Ledger account. On the reverse side, write out the definition, the General Journal entry to record the transaction or the format of the specific General Ledger account. As the year progresses, the number of study vave created will prove useful when preparing for SACs and the exam.

DOCUMENTS USED BY A BUSINESS TO RECORD FINANCIAL TRANSACTIONS

The following types of documents are commonly used by a business as records of financial transactions in VCE Accounting Units 3 and 4:

- Electronic Funds Transfer (EFT) receipt
- Electronic Funds Transfer (EFT) payment
- Cash Receipt
- Sales Invoice
- Purchase Invoice
- Credit Note
- Memo
- Statement of Account
- Bank Statement
- Order
- Shipping and Order Confirmation
- Delivery Docket

For accounting data to be recorded it needs to be accurate so that all users will come to the same conclusion.

For information to be accurate, verifiability requires that the accounting data needs to be able to be verified by a source document through the auditing process.

Exam Tip: Students should attempt to avoid common errors made by students in assessment tasks/examinations when attempting to demonstrate an understanding of 'source documents'. For example, it is important to remember that the location of the business name on the source document determines whether the invoice is a Sales Invoice, a Purchase Invoice, or a Credit Note (that requires a purchase return or sales return entry in the General Journal). Further, if the business's name being recorded appears at the top of an invoice, then the details from this invoice relate to a credit sale of inventory. Alternatively, if the business's name being recorded appears in the middle of an invoice, then the details from this invoice relate to a credit purchase of inventory. If, however, the business's name appears towards the top of a credit note, then details from this credit note relate to a sales return of inventory from a customer. In contrast, if the business's name appears towards the middle of a credit note, details from this credit note relate to a purchase return of inventory to a supplier.

Electronic Funds Transfer (EFT) Receipt

An electronic funds transfer receipt provides evidence of funds being deposited directly into a business' bank account.

The electronic funds transfer receipt amount can be checked against the bank statement.

FIR BANK	
ELECTRONIC FUNDS TRANSFER RECEIPT NUMBER: 1234	
Date:	30 July 2025
Amount:	\$660
FROM:	Weir Racing
TO:	Caldwell's Chocolates

On 30 July 2025 Caldwell's Chocolates received \$660 from Weir Racing to settle their outstanding account. (EFT 1234)

Electronic Funds Transfer (EFT) Payment

Alternatively, an electronic funds transfer payment provides evidence of funds being withdrawn directly from a business' bank account.

The electronic funds transfer payment amount can be checked against the bank statement.

FIR BANK	
	EFT Payment Details
Payment Reference	4722
Payment Date	25 July 2025
To	Ray White
For	August Rent
Amount	\$2 750 including GST
Caldwell's Chocolates	

On 25 July 2025 Caldwell's Chocolates paid Ray White \$2 750 including GST for August's rent. (EFT 4722)

Cash Receipt

Caldwell's Chocolates	
1 Bucket Street Wonkerville VIC 3999	
CASH RECEIPT	
Receipt #	412
Date	24 July 2025
Cash received from	Nine Network
of	\$770
for	December's account.
<i>Matilda Caldwell</i>	

On 24 July 2025 Nine Network was issued receipt 412 by Caldwell's Chocolates for paying the \$770 owing from December 2024.



Sales Invoice

Caldwell's Chocolates			
Date: 26/07/2025		Tax Invoice: 2884	
Charge to: Arthur Slugworth			
Item	Qty	Unit Cost	\$
'Classic' Box	8	\$40	\$320
			<u>GST \$32</u>
		Total Owing	\$352
Credit Terms: 2/7, n/30			

On 26 July 2025 Arthur Slugworth purchased 8 boxes of 'Classic' chocolates from Caldwell's Chocolates on credit for \$40 plus GST each and was issued invoice 2884.

If Arthur Slugworth pays Caldwell's Chocolates within 7 days of 26 July 2025 he is entitled to a 2 per cent discount. Alternatively, Arthur Slugworth is required to pay Caldwell's Chocolates within 30 days of 26 July 2025.

Purchase Invoice

On 27 July 2025 Caldwell's Chocolates purchased 10 boxes of 'Standard' chocolates from Donaldson's Dairy on credit for \$20 plus GST each and was issued invoice 1442.

If Caldwell's Chocolates pays Donaldson's Dairy within 5 days of 27 July 2025 he is entitled to a 5 per cent discount. Alternatively, Caldwell's Chocolates is required to pay Donaldson's Dairy within 28 days of 27 July 2025.

Donaldson's Dairy			
Date: 27/07/2025		Tax Invoice: 1442	
Charge to: Caldwell's Chocolates			
Item	Qty	Unit Cost	\$
'Standard' Box	10	\$20	\$200
			<u>GST \$20</u>
		Total Owing	\$220
Credit Terms: 5/10, n/28			



Credit Note – Sales Return

Caldwell’s Chocolates			
Date: 28/07/2025		Credit Note: 13	
Credit: Beau Regarde			
Item	Qty	Unit Cost	\$
'Sampler' Box	1	\$10	\$10
			<u>GST \$1</u>
		Total Credit	\$11

On 28 July 2025 Beau Regarde returned 1 box of 'Sampler' chocolates to Caldwell's Chocolates. Beau Regarde received a credit of \$10 plus GST reducing the amount they owed to Caldwell's Chocolates and was issued credit note 13.

Credit Note – Purchase Return

Ian’s Imports			
Date: 29/07/2025		Credit Note: 167	
Credit: Caldwell’s Chocolates			
Item	Qty	Unit Cost	\$
'BIG' Collection	15	\$30	\$450
			<u>GST \$45</u>
		Total Credit	\$495

On 29 July 2025 Caldwell's Chocolates returned 15 boxes of 'BIG' collection chocolates to Ian's Imports. Caldwell's Chocolates received a credit of \$450 plus GST reducing the amount they owed to Ian's Imports and was issued credit note 167.

Memo

The purpose of a memo being completed is to document any non-cash transactions occurring within a business or transactions involving the owner.

Caldwell’s Chocolates	
MEMO # 35	Date 31 August 2025
Bee Carson's debt of \$550 needs to be written off.	
	<i>Matilda Caldwell</i>

On 31 August 2025 Matilda Caldwell of Caldwell's Chocolates has instructed her accountant to write off Bee Carson's debt of \$550.

Bank Statement

A bank statement shows all the cash transactions of a business and their bank. It provides a 'cross-checking' mechanism for the business to compare the actual cash received and cash paid with their own records for accuracy.

CCA BANK				
BANK STATEMENT				
Caldwell’s Chocolates				
Date	Particulars	Debit	Credit	Balance
24/07	Cash		770	6 430 CR
26/07	EFT 218	2 750		3 680 CR

Statement of Account

Similarly to the Bank Statement, a Statement of Account shows all the transactions between a supplier and their credit customers. It provides a 'cross-checking' mechanism for the business to compare the actual transactions and balance owing at the end of a month with their own records.

Phillip's Products 88 Main Road BALWYN VIC 3103 STATEMENT OF ACCOUNT				
Account Name: Caldwell's Chocolates 1 Bucket Street WONKERVILLE VIC 3999				
Date: 31 August 2025				
Date	Details	Debit	Credit	Balance
01/08	Balance			6 600 DR
04/08	Payment Received		6 468	132 DR
04/08	Discount Allowed		132	Nil
09/08	Invoice 349	10 560		10 560 DR
11/08	Credit Note 17		550	10 010 DR
29/08	Payment Received		2 000	8 010 DR

Order

An order form is used to request inventory from a supplier.

<h3 style="margin: 0;">Caldwell's Chocolates</h3> <p style="margin: 0;">1 Bucket Street Wonkerville VIC 3999</p> <p style="margin: 10px 0 0 0;">ORDER FORM</p>	
TO: Donaldson's Dairy	DATE: 18 July 2025
Inventory Item 'Standard' Box	Quantity 10
<i>Matilda Caldwell</i>	

Shipping and Order Confirmation

A shipping and order confirmation form communicates with a customer that their inventory order has been sent and will arrive shortly.

DONALDSON'S DAIRY	
SHIPPING CONFIRMATION	
Australia Post Tracking Number: 19780316	
TO: Caldwell's Chocolates	DATE: 20 July 2025
1 Bucket Street	
Wonkerville VIC 3999	
The following items have been included in your most recent order and have been dispatched today.	
Inventory Item	Quantity
'Standard' Box	10
<i>Donald Donaldson</i>	

Delivery Docket

A delivery docket provides a description of the inventory items that have been delivered and acts as evidence that the inventory items were received by the customer.

Caldwell's Chocolates	
1 Bucket Street	
Wonkerville VIC 3999	
DELIVERY DOCKET	
DATE: 26 July 2025	REF: 26072884
TO: Arthur Slugworth	
24 Elevator Grove	
Glen Iris VIC 3146	
Inventory Item(s)	Quantity
'Classic' Box	8
<i>Inspected:</i>	
<i>Received:</i>	

Exam Tip: Students need to be mindful that an Order, Shipping and Order Confirmation and Delivery Docket do not constitute a financial transaction and require no entry in the General Journal.

ACCOUNTING ELEMENTS

Element	Definition
Asset	An asset is a present economic resource controlled by the entity as a result of past events.
Liability	A liability is a present obligation of the entity to transfer an economic resource as a result of past events.
Owner's Equity	Owner's Equity is the residual interest in the assets of the entity after deducting all its liabilities.
Revenue	Revenue is an increase in assets or decreases in liabilities that result in an increase in owner's equity, other than those relating to contributions from the owner.
Expenses	An expense is a decrease in assets or an increase in liabilities that result in a decrease in owner's equity, other than those relating to distributions to the owner.



Exam Tip: Even though it is recommended that definitions are memorised, it is the application of the specific components that is crucial to achieving full marks for questions relating to revenues and expenses.

CLASSIFICATION OF ASSETS AND LIABILITIES

Classification	Definition	Examples
Current Asset	Current assets are reasonably expected to be converted to cash, sold or consumed by a business within 12 months after the end of the reporting period.	Bank Accounts Receivable Inventory Prepaid Expenses Accrued Revenue GST Clearing (Refund)
Non-Current Asset	Non-current assets are expected to be used by the business entity for a number of years.	Equipment Shelving Van
Current Liability	Current liabilities are obligations of the entity that are reasonably expected to be settled within 12 months of the end of the reporting period.	Bank Overdraft Accounts Payable Accrued Expenses Unearned Revenue Loan GST Clearing
Non-Current Liability	Non-current liabilities are obligations of the entity that are not required to be settled within 12 months after the end of the reporting period.	Loan

Exam Tip: The classification of Assets and Liabilities between 'Current' and 'Non-Current' on a business's Balance Sheet satisfies the qualitative characteristic of Understandability.

Through the use of headings and sub-headings, totals and sub-totals, classifying items presents information in a manner that enables users with reasonable knowledge of business activities to understand the report.

GENERAL LEDGER WITH T

Ledger accounts are accounting records that record all increases and decreases of that item during a reporting period. The group of individual ledger accounts is known as the General Ledger.

Name of Ledger

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	DEBIT SIDE			CREDIT SIDE	

The rules for recording transactions in the General Ledger depend upon which accounting element is represented in each account.

Asset

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	INCREASE			DECREASE	

Liability

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	DECREASE			INCREASE	

Owner's Equity

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	DECREASE			INCREASE	

Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	DECREASE			INCREASE	

Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	INCREASE			DECREASE	

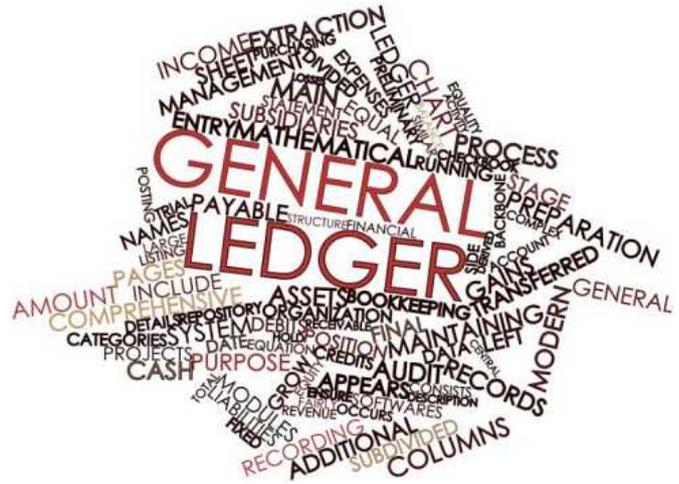
Exam Tip: To perform well in the examination, students must know how to record the details from all source documents into each General Ledger account. For example, student responses in a recent exam highlighted that some students experienced difficulty posting details from multiple source documents directly into the GST Clearing account.

GENERAL JOURNAL AND GENERAL LEDGER – ESTABLISHMENT OF DOUBLE

On 1 January 2025 Matilda Caldwell, the owner of Caldwell’s Chocolates, had the following asset and liability balances.

	\$	
Accounts Payable	12 800	
Accounts Receivable	16 500	
Bank	9 860	
Equipment	19 200	
GST Clearing	1 073	[credit]
Inventory	14 300	
Loan – MNC Bank	15 000	
Shelving	7 400	

Prepare the General Journal entry required to establish a double entry accounting system.



Exam Tip: Students should remember to label each of the account balances with either an A (for Assets) or L (for Liabilities). Each account balance with an A would be recorded as a debit. Each account balance with an L would be recorded as a credit. Students need to total the value of the Assets and deduct the total value of the Liabilities in order to calculate capital. This ensures the accounting equation balances. It is important that students do not assume that the balance of the Bank will be a debit and the balance of the GST Clearing will be a credit. Even though the business may have a Bank Overdraft, the name of the ledger account will remain 'Bank'.

General Journal

Date	Details	Debit	Credit
01/01	Accounts Payable		12 800
	Accounts Receivable	16 500	
	Bank	9 860	
	Equipment	19 200	
	GST Clearing		1 073
	Inventory	14 300	
	Loan – MNC Bank		15 000
	Shelving	7 400	
	Capital		38 387

Post the General Journal entry establishing the double entry accounting system to the General Ledger.

General Ledger

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	9 860			

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	16 500			

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	14 300			

Equipment

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	19 200			

Shelving

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	7 400			

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/01	Balance	12 800

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/01	Balance	1 073

Loan – MNC Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/01	Balance	15 000

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/01	Balance	38 387

GENERAL JOURNAL AND GENERAL LEDGER CONTRIBUTION OF NON AT FAIR VALUE

On 3 January 2025 Matilda Caldwell, the owner of Caldwell's Chocolates, contributed her Van to the business for the purposes of deliveries. Matilda originally purchased the Van in 2017 for \$35 000 plus GST. Matilda believes the fair value of the Van to be \$18 000.

Prepare the General Journal entry required to record this transaction and **post** it to the General Ledger.

General Journal

Date	Details	Debit	Credit
03/01	Van	18 000	
	Capital		18 000

General Ledger (extract)

Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
03/01	Capital	18 000			

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/01	Balance	38 387
			03/01	Van	18 000

Issues relating to the use of fair values

Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date.

Exam Tip: In the examination, it would be reasonably expected that students can discuss, making specific reference to qualitative characteristics, whether non-cash assets contributed to the business by the owner should be recorded at their fair value or its original cost.

As outlined above, the fair value of a non-cash asset contributed to a business by an owner is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The problem with assigning a fair value to a non-cash asset is that no two assets are exactly the same in terms of age and condition. Therefore, the use of a fair value is ultimately an estimated value reached by an owner.

The qualitative characteristic of relevance supports the use of fair values. Relevance outlines that information is relevant when it is capable of making a difference to the decisions made by users. Fair values are more relevant than an asset's original cost as it provides an estimate of the future economic benefits the asset is expected to provide the business from the date it is contributed by the owner.

However, the qualitative characteristic of verifiability does not support the use of fair values. Verifiability outlines that the information reported will mean that all users will reach the same conclusion. No two individuals will agree with the estimated value of an asset. An event will be faithfully represented when it can be verified by keeping source documents and checked through the auditing process. The use of fair values is that it is subject to the bias of the owner and can't be checked with reference to a source document.

GENERAL JOURNAL AND GENERAL LEDGER CREDIT PURCHASES OF

On 6 January 2025 Caldwell's Chocolates purchased inventory from Donaldson's Dairy for \$9 350 including GST (Invoice 1088). Donaldson's Dairy's credit terms are 2/7, n/30.

Prepare the General Journal entry required to record this transaction and **post** it to the General Ledger.

General Journal

Date	Details	Debit	Credit
06/01	Inventory	8 500	
	GST Clearing	850	
	Accounts Payable		9 350

General Ledger (extract)

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	14 300			
06/01	Accounts Payable	8 500			

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
06/01	Accounts Payable	850	01/01	Balance	1 073

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/01	Balance	12 800
			06/01	Inventory / GST Clearing	9 350

EFFECT OF TRANSACTION ON ACCOUNTING EQUATION

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Inventory	Increase	\$8 500
Liabilities	Accounts Payable ↑ by \$9 350 / GST Clearing ↓ by \$850	Increase	\$8 500
Owner's Equity		No Effect	\$0

EXPLANATION

As a result of the transaction on 6 January 2025, Assets (Inventory) would increase by \$8 500, Liabilities would increase **overall** by \$8 500 as Accounts Payable would increase by \$9 350 but GST Clearing would decrease by \$850, and there would be no effect on Owner's Equity.

GENERAL JOURNAL AND GENERAL LEDGER PURCHASE RETURNS TO

On 9 January 2025 Caldwell's Chocolates returned inventory to Donaldson's Dairy and received a credit of \$550 including GST (Credit Note 14).

Prepare the General Journal entry required to record this transaction and **post** it to the General Ledger.

General Journal

Date	Details	Debit	Credit
09/01	Accounts Payable	550	
	Inventory		500
	GST Clearing		50

General Ledger (extract)

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
09/01	Inventory / GST Clearing	550	01/01	Balance	12 800
			06/01	Inventory / GST Clearing	9 350

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	14 300	09/01	Accounts Payable	500
06/01	Accounts Payable	8 500			

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
06/01	Accounts Payable	850	01/01	Balance	1 073
			09/01	Accounts Payable	50

EFFECT OF TRANSACTION ON ACCOUNTING EQUATION

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Inventory	Decrease	\$500
Liabilities	Accounts Payable ↓ by \$550 / GST Clearing ↑ by \$50	Decrease	\$500
Owner's Equity		No Effect	\$0

EXPLANATION

As a result of the transaction on 9 January 2025, Assets (Inventory) would decrease increase by \$500, Liabilities would decrease **overall** by \$500 as Accounts Payable would decrease by \$550 but GST Clearing would increase by \$50, and there would be no effect on Owner's Equity.

GENERAL JOURNAL AND GENERAL LEDGER CASH PAYMENTS

On 12 January 2025 Caldwell's Chocolates paid Donaldson's Dairy the outstanding amount. (EFT 347)

Prepare the General Journal entry required to record this transaction and **post** it to the General Ledger.

General Journal

Date	Details	Debit	Credit
12/01	Accounts Payable	8 800	
	Bank		8 624
	Discount Revenue		176

Exam Tip: During reading time of the examination or a SAC time, it is important to make a mental note of dates and any reference to credit terms. For example, in relation to the current exercise, on 6 January 2019 Caldwell's Chocolates purchased inventory on credit. The supplier's credit terms were 2/7, n/30. A payment was then made on 12 January 2019. Therefore, Caldwell's Chocolates were entitled to a 2 per cent discount off the net amount owing. A complication to this event is that there was a purchase return of inventory on 9 January 2019. This reduced the amount Caldwell's Chocolates owed their supplier. It is this net amount owing that is the basis for the calculation of the discount, not the amount owing from the original credit purchase of inventory. $[(\$9\,350 - \$550) \times 0.02 = \$176]$

General Ledger (extract)

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
09/01	Inventory / GST Clearing	550	01/01	Balance	12 800
12/01	Bank / Discount Revenue	8 800	06/01	Inventory / GST Clearing	9 350

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	9 860	12/01	Accounts Payable	8 624

Discount Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			12/01	Accounts Payable	176

EFFECT OF TRANSACTION ON ACCOUNTING EQUATION

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Bank	Decrease	\$8 624
Liabilities	Accounts Payable	Decrease	\$8 800
Owner's Equity	Net Profit (Discount Revenue)	Increase	\$176

EXPLANATION

As a result of the transaction on 12 January 2025, Assets (Bank) would decrease by \$8 624, Liabilities (Accounts Payable) would decrease by \$8 800 and Owner's Equity (Net Profit) would increase by \$176.

Exam Tip: It is crucial for students to identify the effect of transactions on the accounting equation. A recent exam required students to complete a table to demonstrate how a transaction affected the accounting equation, and a number of students performed poorly. Importantly, not only can students be asked to demonstrate their knowledge of how transactions effect the accounting equation (via the completion of a table), they also need to be able to explain how the accounting equation is effected. The most important aspect of this approach is to explain the overall effect on an accounting element when multiple items effects an accounting element.

How does a discount for prompt payment satisfy the definition of revenue?

When a business pays a supplier within the credit terms and is entitled to a discount, the discount satisfies the definition of revenue as it decreases liabilities that results in an increase in owner's equity, other than that relating to contributions from the owner.

Exam Tip: A reminder that not all of the definition of revenue is required to be included in a response. In terms of the response above, it is incorrect for students to include any reference to assets increasing.

Examples of Other Cash Payments

During January 2025 Caldwell's Chocolates also made the following payments.

- 13/01 Ian's Imports were paid \$1 650 (EFT 8456) for the amount owing from a credit purchase of Inventory in December 2024.
- 15/01 Monthly loan repayment to MNC Bank of \$750 (Bank Statement). Each repayment includes \$250 of interest.
- 18/01 Inventory of \$2 200 including GST purchased from Bradbury's (EFT 7432).
- 21/01 The Australian Taxation Office was paid the GST owing of \$1 073 from December 2024. (EFT 9032)
- 27/01 Matilda withdrew \$1 250 for personal use (EFT 8311).
- 29/01 Advertising for \$440 including GST was paid (EFT 6614).
- 31/01 Additional Shelving costing \$3 300 plus GST purchased from Sidney Norman (EFT 3543).

Prepare the General Journal entries required to record these transactions and **post** them to the General Ledger.

Exam Tip: It is very important not to confuse the words 'plus GST' and 'including GST'. When the transaction is described as 'plus GST', 10 per cent of the item is added in order to calculate the GST amount and the total of the payment. In contrast, when the transaction is described as 'including GST', the total amount of the payment needs to be divided by 11 in order to calculate the GST amount.

General Journal

Date	Details	Debit	Credit
13/01	Accounts Payable	1 650	
	Bank		1 650
15/01	Loan – MNC Bank	500	
	Interest Expense	250	
	Bank		750
18/01	Inventory	2 000	
	GST Clearing	200	
	Bank		2 200
21/01	GST Clearing	1 073	
	Bank		1 073
27/01	Drawings	1 250	
	Bank		1 250
29/01	Advertising	400	
	GST Clearing	40	
	Bank		440
31/01	Shelving	3 300	
	GST Clearing	330	
	Bank		3 630

General Ledger (extract)**Bank**

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	9 860	12/01	Accounts Payable	8 624
			13/01	Accounts Payable	1 650
			15/01	Loan – MNC Bank/Interest Expense	750
			18/01	Inventory / GST Clearing	2 200
			21/01	GST Clearing	1 073
			27/01	Drawings	1 250
			29/01	Advertising / GST Clearing	440
			31/01	Shelving / GST Clearing	3 630

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	14 300	09/01	Accounts Payable	500
06/01	Accounts Payable	8 500			
18/01	Bank	2 000			

Shelving

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	7 400			
31/01	Bank	2 000			

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
09/01	Inventory / GST Clearing	550	01/01	Balance	12 800
12/01	Bank / Discount Revenue	8 800	06/01	Inventory / GST Clearing	9 350
13/01	Bank	1 650			

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
06/01	Accounts Payable	850	01/01	Balance	1 073
18/01	Bank	200	09/01	Accounts Payable	50
21/01	Bank	1 073			
29/01	Bank	40			
31/01	Bank	330			

Loan – MNC Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
15/01	Bank	500	01/01	Balance	15 000

Drawings

Date	Cross-reference	Amount	Date	Cross-reference	Amount
27/01	Bank	1 250			

Advertising

Date	Cross-reference	Amount	Date	Cross-reference	Amount
29/01	Bank	400			

Interest Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
15/01	Bank	250			

PERCENTAGE MARK-UP

A mark-up is a percentage of the cost price that is added to the cost price to determine a selling price.

Exam Tip: When given a cost price (excluding GST) and a mark-up percentage you need to multiply in order to calculate the selling price (excluding GST).

Cost Price (excluding GST)	Mark-Up	Action [1 + % mark-up]	Selling Price (excluding GST)
\$100	50%	x 1.5	\$150
\$100	100%	x 2	\$200
\$100	150%	x 2.5	\$250
\$100	200%	x 3	\$300

Exam Tip: When given a selling price (excluding GST) and a mark-up percentage you need to divide in order to calculate the cost price (excluding GST).

Selling Price (excluding GST)	Mark-Up	Action [1 + % mark-up]	Cost Price (excluding GST)
\$150	50%	/ 1.5	\$100
\$200	100%	/ 2	\$100
\$250	150%	/ 2.5	\$100
\$300	200%	/ 3	\$100

GENERAL JOURNAL AND GENERAL LEDGER CREDIT SALES OF INVENTORY

On 11 January 2025 Draper Hotels purchased inventory from Caldwell's Chocolates for \$4 950 including GST (Invoice 316). These items cost Caldwell's Chocolates \$1 980 including GST. Caldwell's Chocolates' credit terms are 2/7, n/30.

Prepare the General Journal entry required to record this transaction and post it to the General Ledger.

General Journal

Date	Details	Debit	Credit
11/01	Accounts Receivable	4 950	
	Credit Sales		4 500
	GST Clearing		450
	Cost of Sales	1 800	
	Inventory		1 800

Exam Tip: In examinations, it is common for students to misread transactions of this nature. The word 'including' will often cause students some angst. Always remember that when recording the cost price allocated for the item of inventory sold, GST is ignored or removed from the GST inclusive cost.

General Ledger (extract)**Accounts Receivable**

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	16 500			
11/01	Credit Sales / GST Clearing	4 950			

Credit Sales

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			11/01	Accounts Receivable	4 500

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
06/01	Accounts Payable	850	01/01	Balance	1 073
18/01	Bank	200	09/01	Accounts Payable	50
21/01	Bank	1 073	11/01	Accounts Receivable	450
29/01	Bank	40			
31/01	Bank	330			

Cost of Sales

Date	Cross-reference	Amount	Date	Cross-reference	Amount
11/01	Inventory	1 800			

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	14 300	09/01	Accounts Payable	500
06/01	Accounts Payable	8 500	11/01	Cost of Sales	1 800
18/01	Bank	2 000			

EFFECT OF TRANSACTION ON ACCOUNTING EQUATION

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Accounts Receivable ↑ by \$4 950 / Inventory ↓ by \$1 800	Increase	\$3 150
Liabilities	GST Clearing	Increase	\$450
Owner's Equity	Net Profit (Credit Sales ↑ by \$4 500 / Cost of Sales ↑ \$1 800)	Increase	\$2 700

EXPLANATION

As a result of the transaction on 11 January 2025, Assets would increase **overall** by \$3 150 as Accounts Receivable would increase by \$4 950 but Inventory would decrease by \$1 800. Liabilities (GST Clearing) would increase by \$450. Owner's Equity (Capital) would increase **overall** by \$2 700 as Credit Sales would increase by \$4 500 as would Cost of Sales by \$1 800.

GENERAL JOURNAL AND GENERAL LEDGER SALES RETURNS FROM

On 13 January 2025 Draper Hotels returned inventory to Caldwell's Chocolates and received a credit of \$550 including GST (Credit Note 6). These items originally had a cost price of \$200.

Prepare the General Journal entry required to record this transaction and **post** it to the General Ledger.

General Journal

Date	Details	Debit	Credit
13/01	Sales Returns	500	
	GST Clearing	50	
	Accounts Receivable		550
	Inventory	200	
	Cost of Sales		200

General Ledger (extract)

Sales Returns

Date	Cross-reference	Amount	Date	Cross-reference	Amount
13/01	Accounts Receivable	500			

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
06/01	Accounts Payable	850	01/01	Balance	1 073
13/01	Accounts Receivable	50	09/01	Accounts Payable	50
18/01	Bank	200	11/01	Accounts Receivable	450
21/01	Bank	1 073			
29/01	Bank	40			
31/01	Bank	330			

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	16 500	13/01	Sales Returns / GST Clearing	550
11/01	Credit Sales / GST Clearing	4 950			

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	14 300	09/01	Accounts Payable	500
06/01	Accounts Payable	8 500	11/01	Cost of Sales	1 800
13/01	Cost of Sales	200			
18/01	Bank	2 000			

Cost of Sales

Date	Cross-reference	Amount	Date	Cross-reference	Amount
11/01	Inventory	1 800	13/01	Inventory	200

EFFECT OF TRANSACTION ON ACCOUNTING EQUATION

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Inventory ↑ by \$200 / Accounts Receivable ↓ by \$550	Decrease	\$350
Liabilities	GST Clearing	Decrease	\$50
Owner's Equity	Net Profit (Sales Returns ↑ by \$500 / Cost of Sales ↓ \$200)	Decrease	\$300

EXPLANATION

As a result of the transaction on 13 January 2025, Assets would decrease **overall** by \$350 as Inventory would increase by \$200 but Accounts Receivable would decrease by \$550. Liabilities (GST Clearing) would decrease by \$50. Owner's Equity (Capital) would decrease **overall** by \$300 as Sales Returns would increase by \$500 but Cost of Sales would decrease by \$200.

GENERAL JOURNAL AND GENERAL LEDGER CASH RECEIPTS

On 17 January 2025 Caldwell's Chocolates issued Draper Hotels receipt 583 when they paid their outstanding amount.

General Journal

Date	Details	Debit	Credit
17/01	Bank	4 312	
	Discount Expense	88	
	Accounts Receivable		4 400

General Ledger (extract)

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	9 860	12/01	Accounts Payable	8 624
17/01	Accounts Receivable	4 312	13/01	Accounts Payable	1 650
			15/01	Loan – MNC Bank / Interest Expense	750
			18/01	Inventory / GST Clearing	2 200
			21/01	GST Clearing	1 073
			27/01	Drawings	1 250
			29/01	Advertising / GST Clearing	440
			31/01	Shelving / GST Clearing	3 630

Discount Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
17/01	Accounts Receivable	88			

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	16 500	13/01	Sales Returns / GST Clearing	550
11/01	Credit Sales / GST Clearing	4 950	17/01	Bank / Discount Expense	4 400

EFFECT OF TRANSACTION ON ACCOUNTING EQUATION

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Bank ↑ by \$4 312 / Accounts Receivable ↓ by \$4 400	Decrease	\$88
Liabilities		No Effect	\$0
Owner's Equity	Net Profit (Discount Expense)	Decrease	\$88

EXPLANATION

As a result of the transaction on 17 January 2025, Assets would decrease **overall** by \$88 as Bank would increase by \$4 312 but Accounts Receivable would decrease by \$4 400. There would be no effect on Liabilities and Owner's Equity (Net Profit) would decrease by \$88.

How does a discount for prompt payment satisfy the definition of expense?

When a customer pays within the credit terms and is entitled to a discount, the discount satisfies the definition of an expense as it decreases assets that results in a decrease in owner's equity, other than that relating to distributions to the owner.

Examples of Other Cash Receipts

During January 2025 Caldwell's Chocolates also had the following receipts.

18/01 Matilda decided to deposit \$5 000 into her business' bank account.

21/01 Sale made to Kevin Heffernan of \$990 including GST (Receipt 585). The inventory items sold were

marked up by 50%.

- 27/01 Chloe Smith was issued receipt 586 when she paid \$2 200. This amount related to a Credit Sale recorded in December 2024.
- 29/01 Cash Sale of \$380 plus GST (Receipt 587) made to George Ryder. The cost of sales for these items were \$190.

Prepare the General Journal entries required to record these transactions and **post** them to the General Ledger.

General Journal

Date	Details	Debit	Credit
18/01	Bank	5 000	
	Capital		5 000
21/01	Bank	990	
	Cash Sales		900
	GST Clearing		90
	Cost of Sales	600	
	Inventory		600
27/01	Bank	2 200	
	Accounts Receivable		2 200
29/01	Bank	418	
	Cash Sales		380
	GST Clearing		38
	Cost of Sales	190	
	Inventory		190

General Ledger (extract)

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
17/01	Accounts Receivable	4 312	13/01	Accounts Payable	1 650
18/01	Capital	5 000	15/01	Loan – MNC Bank/Interest Expense	750
21/01	Cash Sales / GST Clearing	990	18/01	Inventory / GST Clearing	2 200
27/01	Accounts Receivable	2 200	21/01	GST Clearing	1 073
29/01	Cash Sales / GST Clearing	418	27/01	Drawings	1 250
			29/01	Advertising / GST Clearing	440
			31/01	Shelving / GST Clearing	3 630

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	16 500	13/01	Sales Returns / GST Clearing	550
11/01	Credit Sales / GST Clearing	4 950	17/01	Bank / Discount Expense	4 400
			27/01	Bank	2 200

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Balance	14 300	09/01	Accounts Payable	500
06/01	Accounts Payable	8 500	11/01	Cost of Sales	1 800
13/01	Cost of Sales	200	21/01	Cost of Sales	600
18/01	Bank	2 000	29/01	Cost of Sales	190

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
06/01	Accounts Payable	850	01/01	Balance	1 073
13/01	Accounts Receivable	50	09/01	Accounts Payable	50
18/01	Bank	200	11/01	Accounts Receivable	450
21/01	Bank	1 073	21/01	Bank	90
29/01	Bank	40	29/01	Bank	38
31/01	Bank	330			

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/01	Balance	38 387
			03/01	Van	18 000
			18/01	Bank	5 000

Cash Sales

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			21/01	Bank	900
			29/01	Bank	380

Cost of Sales

Date	Cross-reference	Amount	Date	Cross-reference	Amount
11/01	Inventory	1 800	13/01	Inventory	200
21/01	Inventory	600			
29/01	Inventory	190			

GST CLEARING ACCOUNT

Below is the GST Clearing account from the General Ledger of Caldwell's Chocolates for the month ending 31 January 2025.

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
06/01	Accounts Payable	850	01/01	Balance	1 073
13/01	Accounts Receivable	50	09/01	Accounts Payable	50
18/01	Bank	200	11/01	Accounts Receivable	450
21/01	Bank	1 073	21/01	Bank	90
29/01	Bank	40	29/01	Bank	38
31/01	Bank	330			rep

Why did the GST Clearing account have a credit balance on 1 January 2025?

Caldwell's Chocolates had a credit balance in their GST Clearing account on 1 January 2025 as the amount of GST collected from Cash Sales and the GST charged on Credit Sales was greater than the amount of GST paid on cash payments of expenses and purchases of assets and the GST incurred on credit purchases of assets in period ended 31 December 2024.

How would the GST Clearing account be classified on the Balance Sheet as at 1 January 2025?

As the GST Clearing account had a credit balance on 1 January 2025, the account would be classified as a Current Liability as this amount represents a present obligation of Caldwell's Chocolates to transfer of an economic resource as a result of past events within 12 months of the end of the reporting period.

Why would a GST Clearing account have a debit balance?

A business will have a debit balance at the start of the reporting period as the amount of GST collected from Cash Sales and the GST charged on Credit Sales was less than the amount of GST paid on cash payments of expenses and purchases of assets and the GST incurred on credit purchases of assets during the previous period.

This may have occurred due to a large purchase of stock that remained unsold at the end of the period or the purchase of a non-current asset.

How would a GST Clearing account with a debit balance be classified on the Balance Sheet?

A GST Clearing account with a debit balance would be classified as a Current Asset as this amount represents a present economic resource controlled by the entity as a result of past events where the GST refund is reasonably expected to be received within 12 months after the end of the reporting period.

Exam Tip: A recently common question requires students to identify the type of transaction, describe the transaction or state the source document that would have been referenced when a specific entry in an account in the General Ledger was posted. It is important to note that the specific name of the source document or a detailed description of the transaction is required to be awarded full marks.

FOOTING A LEDGER ACCOUNT

At this stage of your accounting life, General Ledger accounts for Revenues, Expenses, Capital and Drawings can be informally 'footed'.

'Footing' involves simply calculating what the balance of the ledger account is and circling the balance for inclusion in the Trial Balance on the date the Trial Balance is being prepared.

Cash Sales

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			21/01	Bank	900
			29/01	Bank	380
					1 280

Cost of Sales

Date	Cross-reference	Amount	Date	Cross-reference	Amount
11/01	Inventory	1 800	13/01	Inventory	200
21/01	Inventory	600			
29/01	Inventory	190			
		2 390			

GENERAL JOURNAL AND GENERAL LEDGER CORRECTION OF ERRORS

Believe it or not, accountants are not perfect! Sometimes, an accountant may prepare an incorrect General Journal entry or post a General Journal entry to the wrong account in the General Ledger.

One of these errors may be identified on balance day and require a correcting entry to ensure that the accounting reports are more accurate. This will require students to transfer an amount **out** of the incorrect account and post it **into** the correct account.

To illustrate, in the November 2017 VCAA examination, students were told that a payment for Wages of \$280 was incorrectly recorded as a payment for Drawings.

The correcting entry would appear as follows:

General Journal

Date	Details	Debit	Credit
30/06	Wages	280	
	Drawings		280

The effect of this correcting entry is that the \$280 is taken **out** of the Drawings account and posts it **into** the Wages account in the General Ledger.

Exam Tip: Due to a business not being able to deduct any GST paid on transactions of a personal nature from their GST liability, correcting entries appear rarely on exams. In the eight exams conducted under the previous VCAA Study Design, a correcting entry was assessed three times.

PURPOSE AND

The purpose of preparing a Pre-Adjustment Trial Balance is to check that the total debit entries equal the total credit entries in the General Ledger accounts.

The Pre-Adjustment Trial Balance helps to identify any errors in the recording process so that they can be identified and rectified before reports are prepared.

Exam Tip: Understanding the purpose of preparing a Pre-Adjustment Trial Balance is important and students in past examinations have performed poorly in this respect. For example, in the 2017 exam, 71% of students received zero marks out of two for a question requiring them to demonstrate an understanding of the purpose of preparing a Trial Balance.

Caldwell's Chocolates Trial Balance as at 31 January 2025

Account	Debit	Credit
Accounts Payable		11 150
Accounts Receivable	14 300	
Advertising	400	
Capital		61 387
Bank	3 163	
Cash Sales		1 280
Cost of Sales	2 390	
Credit Sales		4 500
Discount Expense	88	
Discount Revenue		176
Drawings	1 250	
Equipment	19 200	
GST Clearing	842	
Interest Expense	250	
Inventory	21 910	
Loan – MNC Bank		14 500
Sales Returns	500	
Shelving	10 700	
Van	18 000	
Totals	92 993	92 993

APPLICATION EXERCISE 2

Gus Brayshaw owns and operates Gus' Gates, a small business that offers their customers credit terms of 2/7, n/30. The following transactions for February 2025 appear as follows.

02/02	Received \$5 500 from Bob's Builders for amount owing from December 2024. (Receipt 348)
05/02	Purchased 20 'Goodwin' gates from MFC for \$3 000 plus GST. (Invoice 2020)
08/02	Advertising of \$825 including GST was paid. (EFT 1729)
11/02	Gus's Gates made a credit sale to a new customer – Tran Towers. Invoice 188 was issued for the sale of \$9 000 plus GST. These items cost Gus's Gates \$3 600 plus GST.
13/02	Sold 3 'Goodwin' gates to Darren Weir for \$500 plus GST each. (Receipt 349) These gates originally cost Gus's Gates \$150 each.
14/02	Tran Towers returned some of the gates sold on 11 February. Gus decided to give them a credit of \$1 100 including GST. (Credit Note 5) These gates original cost Gus's Gates \$400 plus GST.
14/02	Equipment purchased from Drake Designs for \$12 100 plus GST. (EFT 4344)
15/02	Returned 4 'Goodwin' gates to MFC and received a full credit of \$660 including GST. (Credit Note 189)
16/02	Tran Towers were issued receipt 350 when they paid their outstanding account balance.
19/02	Gus withdrew \$2 500 to pay for his daughter's birthday party. (EFT 2996)
21/02	The Australian Taxation Office was paid \$916 for the GST balance owing from January. (Bank Statement)
24/02	Cash Sale of \$2 250 plus GST to Hayes Hotel. (Receipt 351) Gus's Gates applies a mark-up of 50% on these gates sold.
27/02	Paid Gus's Gates major supplier – Mitch Metals - \$4 840. (EFT 8820)

Prepare

APPLICATION EXERCISE 3

The following General Journal entries for February 2025 appear as follows.

General Journal

<i>Date</i>	<i>Details</i>	<i>Debit</i>	<i>Credit</i>
02/02	Cash at Bank	5 500	
	Accounts Receivable		5 500
05/02	Inventory	3 000	
	GST Clearing	300	
	Accounts Payable		3 300
08/02	Advertising	750	
	GST Clearing	75	
	Cash at Bank		825
11/02	Accounts Receivable	9 900	
	Credit Sales		9 000
	GST Clearing		900
	Cost of Sales	3 600	
	Inventory		3 600
13/02	Cash at Bank	1 650	
	Cash Sales		1 500
	GST Clearing		150
	Cost of Sales	450	
	Inventory		450
14/02	Sales Returns	1 000	
	GST Clearing	100	
	Accounts Receivable		1 100
	Inventory	400	
	Cost of Sales		400
14/02	Equipment	12 100	
	GST Clearing	1 210	
	Cash at Bank		13 310

General Journal

Date	Details	Debit	Credit
15/02	Accounts Payable	660	
	Inventory		600
	GST Clearing		60
16/02	Cash at Bank	8 085	
	Discount Expense	165	
	Accounts Receivable		8 250
19/02	Drawings	2 500	
	Cash at Bank		2 500
21/02	GST Clearing	916	
	Cash at Bank		916
24/02	Cash at Bank	2 475	
	Cash Sales		2 250
	GST Clearing		225
	Cost of Sales	1 500	
	Inventory		1 500
27/02	Accounts Payable	4 840	
	Cash at Bank		4 840

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APPLICATION EXERCISE 4

The General Ledger accounts for February 2025 appear as follows.

General Ledger

Cash at Bank

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
01/02	Balance	11 920	08/02	Advertising / GST Clearing	825
02/02	Accounts Receivable	5 500	14/02	Equipment / GST Clearing	13 310
13/02	Cash Sales / GST Clearing	1 650	19/02	Drawings	2 500
16/02	Accounts Receivable	8 624	21/02	GST Clearing	916
24/02	Cash Sales / GST Clearing	2 475	27/02	Accounts Payable	4 840

Accounts Receivable

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
01/02	Balance	14 300	02/02	Bank	5 500
11/02	Credit Sales / GST Clearing	9 900	14/02	Sales Returns / GST Clearing	1 100
			16/02	Bank / Discount Expense	8 800

Inventory

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
01/02	Balance	22 150	11/02	Cost of Sales	3 600
05/02	Accounts Payable	3 000	13/02	Cost of Sales	450
14/02	Cost of Sales	400	15/02	Accounts Payable	600
			24/02	Cost of Sales	1 500

Equipment

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
01/02	Balance	8 640			
14/02	Bank	12 100			

Accounts Payable

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
15/02	Inventory / GST Clearing	660	01/02	Balance	9 940
27/02	Bank	4 840	05/02	Inventory / GST Clearing	3 300

GST Clearing

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
05/02	Accounts Payable	300	01/02	Balance	916
08/02	Bank	75	11/02	Accounts Receivable	900
13/02	Accounts Receivable	100	13/02	Bank	150
14/02	Bank	1 210	15/02	Accounts Payable	60
21/02	Bank	916	24/02	Bank	225

Capital

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
			01/02	Balance	46 154

Drawings

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
19/02	Bank	2 500			

Cash Sales

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
			13/02	Bank	1 500
			24/02	Bank	2 250

Credit Sales

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
			11/02	Accounts Receivable	9 000

Sales Returns

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
14/02	Accounts Receivable	1 000			

Cost of Sales

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
11/02	Inventory	3 600	14/02	Inventory	400
13/02	Inventory	450			
24/02	Inventory	1 500			

Advertising

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
08/02	Bank	750			

Discount Expense

<i>Date</i>	<i>Cross</i>	<i>Amount</i>	<i>Date</i>	<i>Cross</i>	<i>Amount</i>
16/02	Accounts Receivable	176			

Balance

foot

Prepare

DOUBTFUL DEBTS

In order to report relevant information that helps users make informed decisions, all revenues earned and expenses incurred that have occurred during the period are reported in order to calculate the most accurate profit for that period.

On the final date of the reporting period or 'balance day', the Pre-adjustment Trial Balance can be used to calculate the total Net Credit Sales (Credit Sales less Sales Returns) for the reporting period. Management can estimate how much of the Net Credit Sales may not be received and record an Allowance for Doubtful Debts accordingly.

By recording an Allowance for Doubtful Debts, the business is preparing reports in accordance with the Accrual Basis Assumption as all expenses incurred (Bad Debts) are matched against all the revenues earned (Credit Sales) during the period.

Kevin's Keyboards

Pre-adjustment Trial Balance (extract) as at 30 June 2025

Account	Debit	Credit
Accounts Receivable	23 170	
Allowance for Doubtful Debts		970
Cash Sales		17 100
Credit Sales		60 360
Sales Returns	2 860	

Based on historical data, Kevin has a policy to report 2% of Net Credit Sales as a doubtful debt for each period.

As at 30 June 2025 the balance day adjustment to recognise the doubtful debts for the quarter ended 30 June 2025 are as follows.

General Journal

Date	Details	Debit	Credit
30/06	Bad Debts	1 150	
	Allowance for Doubtful Debts		1 150
	$(\$60\,360 - \$2\,860) \times 2\%$		

Exam Tip: When calculating the doubtful debt for a reporting period there is no need to take into account the existing balance of the Allowance for Doubtful Debts. The amount of the Bad Debt adjusting entry is the Net Credit Sales multiplied by the percentage (\$1 150), not the amount to increase the balance of Allowance for Doubtful Debts (\$180) to this amount (from \$970 to \$1 150).

General Ledger (extract)

Bad Debts

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Allowance for Doubtful Debts	1 150	30/06	Profit and Loss Summary	1 150
		1 150			1 150

Allowance for Doubtful Debts

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Balance	2 120	01/04	Balance	970
			30/06	Bad Debts	1 150
		2 120			2 120
			01/07	Balance	2 120

Effect of Recording Allowance on Accounting Equation

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Allowance for Doubtful Debts	Decrease	\$1 150
Liabilities		No Effect	\$0
Owner's Equity	Net Profit (Bad Debts ↑)	Decrease	\$1 150

Kevin's Keyboards

Balance Sheet (extract) as at 30 June 2025

	\$	\$
Current Assets		
Accounts Receivable	23 170	
Less: Allowance for Doubtful Debts	2 120	21 050

An ethical consideration for an accountant is to ensure that the information contained in the financial statements is a faithful representation of the event it represents.

The Net Account Receivables balance should reflect the expected cash to be collected by the business, not the total amount owed. An accountant may choose to either underestimate or overestimate the allowance for doubtful debts to reflect a desired result in either the Income Statement or the Balance Sheet. By adopting this approach, the information contained in the Balance Sheet may not be a faithful representation of the cash expected to be collected by the business. This information may be misleading and not provide the accurate information relevant for users to make an information decision about the allocation of their resources.

WRITING OFF BAD DEBTS

On 1 July 2025 Kevin's Keyboards received notification that one of the Accounts Receivable balances owing \$1 650 has been declared bankrupt.

General Journal

Date	Details	Debit	Credit
01/07	Allowance for Doubtful Debts	1 500	
	GST Clearing	150	
	Accounts Receivable		1 650

General Ledger (extract)

Allowance for Doubtful Debts

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Accounts Receivable	1 500	01/07	Balance	2 120

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Accounts Receivable	150			

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Balance	23 170	01/07	Allowance for Doubtful Debts / GST Clearing	1 650

Kevin's Keyboards

Balance Sheet (extract) as at 1 July 2025

	\$	\$
Current Assets		
Accounts Receivable	21 520	
Less: Allowance for Doubtful Debts	620	20 900

INVENTORY

Both Units 3 and 4 focus on financial accounting for a trading business using the perpetual method of inventory recording. A trading business is one where inventory is purchased and held for sale in the ordinary course of business.

According to the accrual basis assumption, profit is determined by subtracting expenses incurred for a period from revenue earned in that same period. Therefore, each time an item of inventory is sold and the revenue reported in the Income Statement, a Cost of Sales expense amount is also required to be reported.

Determining the Cost of Sales expense amount is complicated because items of inventory on hand may have been purchased at different prices. When a business has purchased items of inventory at different cost prices, and when an item of inventory is sold, how will a business allocate a cost price to be included in the Income Statement?

The VCE Accounting course uses the Specific Identified or First In, First Out (FIFO) cost assignment method.

The Specific Identified cost assignment method is used when the business is able to determine the actual cost price of the item sold by physically marking the unit of inventory or through the use of barcodes. The Specific Identified cost assignment method is possible when a business sells a limited variety of high unit cost items that can be clearly identified from purchase through sale.

But what if the business is unable to specifically identify particular inventory items?

This is where the FIFO cost assignment method is used as it assumes that the first goods purchased are the first to be sold. The FIFO cost assignment method is used when it may be impossible or impractical to keep track of each unit of inventory's original cost. A business that sells hundreds of low unit cost items would use FIFO.

Perpetual Method of Inventory Recording

The VCE Accounting course uses the perpetual method of inventory recording, a system of recording each movement of inventory throughout the reporting period. A business using the perpetual method of inventory recording is required to maintain an inventory card for each item of inventory they sell.

An example of an inventory card is presented below.

ITEM:		Cost method:								
SUPPLIER:		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total

An inventory card records each movement of inventory that comes in or goes out of the business as well as maintaining an ongoing balance of units of inventory on hand.

Advantages of maintaining a perpetual method of inventory recording is that the inventory cards can be used to identify fast and slow moving lines of inventory, assists with the reordering of inventory and inventory losses or gains can be determined by comparing the physical count with the balance of the inventory card. However, additional record keeping and therefore additional costs are incurred when a system of inventory cards are maintained.

FIRST IN, FIRST OUT COST ASSIGNMENT METHOD

BERG'S BOOKS

Darren Berg owns and operates Berg's Books, a small business that uses the FIFO cost assignment method.

Berg's Books will be the business case study used to demonstrate the FIFO cost assignment method for Unit 3 Area of Study 1.

Exam Tip: When recording entries in an inventory card students need to read the transaction carefully and follow these rules:

1. Record the source document and source document number in Details column of Inventory card.
2. The Inventory card only records cost prices. Ignore selling prices. Ignore GST.

Students should also look for the words 'each', 'plus' and 'including' in the transaction.

'Each' refers to quantity of items.

'Plus' refers to GST being added to the cost price.

'Including' refers to GST being included in the cost price. Therefore, the GST inclusive price needs to be divided by 11 to calculate the amount of GST to be subtracted before the cost price is recorded in the Inventory card.

Inventory Purchased

On 3 June 2025 Berg's Books purchased 10 'Trivago Traveller' books from Emperor Publishing for \$33 including GST each (Invoice 3146).

ITEM: 'Trivago Traveller' Book		Cost method: First In, First Out								
SUPPLIER: Emperor Publishing										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							6	30	180
03/06	Inv. 3146	10	30	300				16	30	480

As the cost price of the 'Trivago Traveller' books purchased on 3 June 2025 is the same as the cost price recorded in the Balance column of the inventory card as at 1 June 2025, it is only the quantity of the 'Trivago Traveller' books on hand that needs to be updated.

On 4 June 2025 Berg's Books purchased 15 'Skase' Atlas' from Emperor Publishing for \$50 plus GST each (Invoice 3150).

ITEM: 'Skase' Atlas		Cost method: First In, First Out								
SUPPLIER: Emperor Publishing										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							5	45	225
04/06	Inv. 3150	15	50	750				5	45	225
								15	50	750

As the cost price of the 'Skase' Atlas' purchased on 4 June 2025 is different to the cost price recorded in the Balance column of the inventory card as at 1 June 2025, the purchase is recorded separately in the Balance column.

Inventory Returned to Supplier

The following document outlines that on 6 June 2025 Berg's Books returned 2 'Trivago Traveller' books to Emperor Publishing. Berg's Books received a credit of \$66 including GST reducing the amount they owed to Emperor Publishing and was issued Credit Note 29.

Emperor Publishing			
Date: 06/06/25		Credit Note: 29	
Credit: Berg's Books			
Item	Qty	Unit Cost	\$
'Trivago Traveller' Book	2	\$30	\$60
			GST \$6
			Total Credit \$66

The details from the document would be recorded in Berg's Books' 'Trivago Traveller' book Inventory card as follows.

ITEM: 'Trivago Traveller' Book		Cost method: First In, First Out								
SUPPLIER: Emperor Publishing										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							6	30	180
03/06	Inv. 3146	10	30	300				16	30	480
06/06	C/N 29				2	30	60	14	30	420

The details from the document would be recorded in the General Journal of Berg's Books as follows.

General Journal

Date	Details	Debit	Credit
06/06	Accounts Payable	66	
	Inventory		60
	GST Clearing		6
	2 'Trivago Traveller' books returned to supplier (Credit Note 29)		

Exam Tip: This is the first General Journal entry where a narration has been included. A narration is a brief description of the General Journal entry where further information can be obtained by looking at the source document. A narration is to include the quantity of items, the type of item, a brief description of the General Journal entry and the source document.

The following document outlines that on 8 June 2025 Berg's Books returned 2 'Skase' Atlas' to Emperor Publishing. Berg's Books received a credit of \$110 including GST reducing the amount they owed to Emperor Publishing and was issued Credit Note 31.

Emperor Publishing			
Date: 08/06/25		Credit Note: 31	
Credit: Berg's Books			
Item	Qty	Unit Cost	\$
'Skase' Atlas	2	\$50	\$100
			<u>GST \$10</u>
			Total Credit \$110

The details from the document would be recorded in Berg's Books' 'Skase' Atlas' Inventory card as follows.

ITEM: 'Skase' Atlas		Cost method: First In, First Out								
SUPPLIER: Emperor Publishing										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							5	45	225
04/06	Inv. 3150	15	50	750				5	45	225
								15	50	750
08/06	C/N 31				2	50	100	5	45	225
								13	50	650

The details from the document would be recorded in the General Journal of Berg's Books as follows.

General Journal

Date	Details	Debit	Credit
08/06	Accounts Payable	110	
	Inventory		100
	GST Clearing		10
	2 'Skase' Atlas' returned to supplier (Credit Note 31)		

Exam Tip: The cost price for a purchase return will be identified on the supplier's credit note. It makes sense that the amount of credit provided by the supplier per item will be the same as the amount charged from the most recent purchase on 4 June 2019.

Inventory Sold

The following document outlines that on 12 June 2025 Waller Hotels purchased 5 'Trivago Traveller' books from Berg's Books on credit for \$60 plus GST each and was issued Invoice 267.

Berg's Books			
Date: 12/06/25		Invoice: 267	
Charge To: Waller Hotels			
Item	Qty	Unit Cost	\$
'Trivago Traveller' Book	5	\$60	\$300
			GST \$30
			Total Owing \$330

The details from the document would be recorded in Berg's Books' 'Trivago Traveller' book Inventory card as follows.

ITEM: 'Trivago Traveller' Book		Cost method: First In, First Out								
SUPPLIER: Emperor Publishing										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							6	30	180
03/06	Inv. 3146	10	30	300				16	30	480
06/06	C/N 29				2	30	60	14	30	420
12/06	Inv. 267				5	30	150	9	30	270

The details from the document would be recorded in the General Journal of Berg's Books as follows.

General Journal

Date	Details	Debit	Credit
12/06	Credit Sales		300
	GST Clearing		30
	Accounts Receivable	330	
	Cost of Sales	150	
	Inventory		150
	5 'Trivago Traveller' books sold to Waller Hotels (Invoice 267)		

The First In, First Out (FIFO) cost assignment method assumes that the cost prices of the items will be allocated as an expense in the order in which they were purchased. That is, the quantities and cost prices to appear in the 'OUT' column when an item is sold will come from the oldest inventory values in the 'Balance' column first. Once these quantities and values have been exhausted, the quantities and values will come from the next line in the 'Balance' column.

The following document outlines that on 14 June 2025 NYC School purchased 8 'Skase' Atlas' from Berg's Books on credit for \$140 plus GST each and was issued Invoice 273.

Berg's Books			
Date: 14/06/25		Invoice: 273	
Charge To: NYC School			
Item	Qty	Unit Cost	\$
'Skase' Atlas	8	\$140	\$1 120
			<u>GST \$112</u>
		Total Owing	\$1 232

The details from the document would be recorded in Berg's Books' 'Skase' Atlas' Inventory card as follows.

ITEM: 'Skase' Atlas		Cost method: First In, First Out								
SUPPLIER: Emperor Publishing										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							5	45	225
04/06	Inv. 3150	15	50	750				5	45	225
								15	50	750
08/06	C/N 31				2	50	100	5	45	225
								13	50	650
14/06	Inv. 273				5	45	225	5	45	225
					3	50	150	13	50	650
								10	50	500

Under the perpetual inventory system, whenever there is a movement of inventory it is recorded in an Inventory card. Therefore, when an item of inventory is sold the Inventory card is used to allocate a cost price.

As Berg's Books is using the FIFO cost assignment method, when 8 'Skase' Atlas' were sold on 14 June 2025 the 5 units with a cost price of \$45 have been allocated first, with the remaining 3 units sold being allocated with the cost price of \$50.

Therefore, the total Cost of Sales for Invoice 273 would be \$375 (\$225 + \$150)

The details from the document would be recorded in the General Journal of Berg's Books as follows.

General Journal

Date	Details	Debit	Credit
12/06	Credit Sales		1 120
	GST Clearing		112
	Accounts Receivable	1 232	
	Cost of Sales	375	
	Inventory		375
	8 'Skase' Atlas' sold to NYC School (Invoice 273)		

Exam Tip: There is a relationship between an Inventory card and the General Journal. Any total value amount recorded in the IN column of an Inventory card would be recorded as a Debit to Inventory in the General Journal. Likewise, any total value amount recorded in the OUT column of an Inventory card would be recorded as a Credit to Inventory in the General Journal.

Inventory Returned by Customer

The most difficult aspect of applying the FIFO cost assignment method is determining the cost price to be recorded in the In column of the Inventory card when Inventory is returned by a customer.

When there is only one cost price recorded throughout the Inventory card, such as with the 'Trivago Traveller' book example below, there can only be one value used when recording a Sales Return in the In column of the Inventory card and the General Journal.

The following document outlines that on 15 June 2025 Waller Hotels returned 2 'Trivago Traveller' books to Berg's Books. Waller Hotels received a credit of \$132 including GST reducing the amount they owed and was issued Credit Note 9.

Berg's Books			
Date: 15/06/25		Credit Note: 9	
Credit: Waller Hotels			
Item	Qty	Unit Cost	\$
'Trivago Traveller' Book	2	\$60	\$120
			<u>GST \$12</u>
		Total Credit	\$132

The details from the document would be recorded in Berg's Books' 'Trivago Traveller' book Inventory card as follows.

ITEM: 'Trivago Traveller' Book		Cost method: First In, First Out								
SUPPLIER: Emperor Publishing										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							6	30	180
03/06	Inv. 3146	10	30	300				16	30	480
06/06	C/N 29				2	30	60	14	30	420
12/06	Inv. 267				5	30	150	9	30	270
15/06	C/N 9	2	30	60				11	30	330

The details from the document would be recorded in the General Journal of Berg's Books as follows.

General Journal

Date	Details	Debit	Credit
15/06	Sales Returns	120	
	GST Clearing	12	
	Accounts Receivable		132
	Inventory	60	
	Cost of Sales		60
	2 'Trivago Traveller' books returned by Waller Hotels (C/N 9)		

However, when there are multiple cost prices recorded throughout the Inventory card, such as the 'Skase' Atlas example below, students need to determine the cost price for the Sales Return entry in the General Journal by using the most recent value in the Out column, or, applying FIFO in reverse.

The following document outlines that on 18 June 2025 NYC School returned 2 'Skase' Atlas' to Berg's Books. NYC School received a credit of \$308 including GST reducing the amount they owed and was issued Credit Note 10.

Berg's Books			
Date: 18/06/25		Credit Note: 10	
Credit: NYC School			
Item	Qty	Unit Cost	\$
'Skase' Atlas	2	\$140	\$280
		GST	\$28
		Total Credit	\$308

The details from the document would be recorded in Berg's Books' 'Skase' Atlas' Inventory card as follows.

ITEM: 'Skase' Atlas		Cost method: First In, First Out								
SUPPLIER: Emperor Publishing										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							5	45	225
04/06	Inv. 3150	15	50	750				5	45	225
								15	50	750
08/06	C/N 31				2	50	100	5	45	225
								13	50	650
14/06	Inv. 273				5	45	225			
					3	50	150	10	50	500
18/06	C/N 10	2	50	100				12	50	600

The details from the document would be recorded in the General Journal of Berg's Books as follows.

General Journal

Date	Details	Debit	Credit
18/06	Sales Returns	280	
	GST Clearing	28	
	Accounts Receivable		308
	Inventory	100	
	Cost of Sales		100
	2 'Skase' Atlas' returned by NYC School (C/N 10)		

Exam Tip: Students need to be mindful of how to apply FIFO in reverse. In particular, what if in the 'Skase' Atlas example above, 4 of the Atlas' were returned instead of just 2? How would the Cost of Sales value be determined? Students would work their way up the Out column until 4 Atlas' have had a cost price allocated. The Cost of Sales value for the Sales Return of 4 Atlas' would be \$195, being 3 with a cost price of \$50 and the additional Atlas with a cost price of \$45. The In column would then record the Sales Return on 18 June as 1 at \$45 and 3 at \$50. The Balance column would then record 1 at \$45 and 13 at \$50.

Drawings of Inventory

The following document outlines that on 20 June 2025 Darren Berg, the owner of Berg’s Books, withdrew 1 ‘Tufnell’ diary for personal use. Darren recorded this event on Memo 26.

BERG’S BOOKS	
MEMO # 26	Date 20 June 2025
Withdrew 1 ‘Tufnell’ diary for personal use.	
<i>Darren Berg</i>	

As Berg’s Books is using the FIFO cost assignment method, the value allocated to the withdrawal of the Inventory item is determined as per the oldest cost price in the Balance column of the Inventory card.

The details from the document would be recorded in Berg’s Books’ ‘Tufnell’ diary Inventory card as follows.

ITEM: ‘Tufnell’ Diary		Cost method: First In, First Out								
SUPPLIER: Oliver Books										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							5	18	90
03/06	EFT 114	20	20	400				5	18	90
								20	20	400
20/06	Memo 26				1	18	18	4	18	72
								20	20	400

The details from the document would be recorded in the General Journal of Berg’s Books as follows.

General Journal

Date	Details	Debit	Credit
20/06	Drawings	18	
	Inventory		18
	1 ‘Tufnell’ diary withdrawn for personal use (Memo 26)		

Inventory Used for Advertising

The following document outlines that on 24 June 2025 Darren Berg, the owner of Berg’s Books, donated 2 ‘McAlister’s Gardening’ books to Cairns Primary School as prizes in their fundraising raffle. Darren recorded this event on Memo 27.

BERG’S BOOKS	
MEMO # 27	Date 24 June 2025
Donated 2 ‘McAlister’s Gardening’ books to Cairns Primary School.	
<i>Darren Berg</i>	

As Berg's Books is using the FIFO cost assignment method, the value allocated to the withdrawal of the Inventory item is determined as per the Inventory card.

The details from the document would be recorded in Berg's Books' 'McAlister's Gardening' book Inventory card as follows.

ITEM: 'McAlister's Gardening' Book		Cost method: First In, First Out								
SUPPLIER: Mulch Books										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							3	35	105
18/06	EFT 138	10	39	390				3	35	105
								10	39	390
24/06	Memo 27				2	35	70	1	35	35
								10	39	390

The details from the document would be recorded in the General Journal of Berg's Books as follows.

General Journal

Date	Details	Debit	Credit
24/06	Advertising	70	
	Inventory		70
	2 'McAlister's Gardening' books donated to Cairn's Primary (Memo 27)		

Inventory Loss

Under the FIFO cost assignment method, an Inventory Loss value is determined by using the oldest cost price in the Balance column in the Inventory card on the date of the Inventory count.

The following document outlines that on 30 June 2025 a physical inventory count determined an inventory loss of two 'Tufnell' diaries.

BERG'S BOOKS	
MEMO # 31	Date 30 June 2025
Inventory loss of 2 'Tufnell' diaries as per inventory count.	
	<i>Darren Berg</i>

The details from the document would be recorded in Berg's Books' 'Tufnell' diary Inventory card as follows.

ITEM: 'Tufnell' Diary		Cost method: First In, First Out								
SUPPLIER: Oliver Books										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							5	18	90
03/06	EFT 114	20	20	400				5	18	90
								20	20	400
20/06	Memo 26				1	18	18	4	18	72
								20	20	400
30/06	Memo 31				2	18	36	2	18	36
								20	20	400

The details from the document would be recorded in the General Journal of Berg's Books as follows.

General Journal

Date	Details	Debit	Credit
30/06	Inventory Loss	36	
	Inventory		36
	Inventory loss of 2 'Tufnell' diaries per inventory count (Memo 31)		

Inventory Gain

Under the FIFO cost assignment method, an Inventory Gain value is determined by using the most recent value in the In column of the Inventory card.

The following document outlines that on 30 June 2025 a physical inventory count determined an inventory gain of one 'McAlister Gardening' book.

BERG'S BOOKS	
MEMO # 32	Date 30 June 2025
Inventory gain of 1 'McAlister's Gardening' book as per inventory count.	
	<i>Darren Berg</i>

The details from the document would be recorded in Berg's Books' 'McAlister's Gardening' book Inventory card as follows.

ITEM: 'McAlister's Gardening' Book		Cost method: First In, First Out								
SUPPLIER: Mulch Books										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							3	35	105
18/06	EFT 138	10	39	390				3	35	105
								10	39	390
24/06	Memo 27				2	35	70	1	35	35
								10	39	390
30/06	Memo 32	1	39	39				1	35	35
								11	39	429

The details from the document would be recorded in the General Journal of Berg's Books as follows.

General Journal

Date	Details	Debit	Credit
30/06	Inventory	39	
	Inventory Gain		39
	Inventory gain of 1 'McAlister's Gardening' book per inventory count (Memo 32)		

APPLICATION EXERCISE

Rohit Sharma owns and operates Rohit's Rugs, a small business that uses the First In, First Out cost assignment method to value its inventory.

The following transactions relates to the 'Dhawan' rug for June 2025.

05/06	Purchased 15 'Dhawan' rugs from Tonka Threads for \$660 including GST each (Invoice 175).
09/06	Sold 2 'Dhawan' rugs to Ben Folds for \$1 540 including GST each (Receipt 412).
16/06	Hihett Hotels purchased 8 'Dhawan' rugs for \$13 200 including GST (Invoice 309).
18/06	Credit Note 24 issued to Hihett Hotels for the return of 3 'Dhawan' rugs and received a full credit.
20/06	Rohit's Rugs returned the 3 'Dhawan' rugs to Tonka Threads and received a full credit (Credit Note 47).
30/06	A physical count determined 11 'Dhawan' rugs on hand (Memo 52).

Record only

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IDENTIFIED COST ASSIGNMENT METHOD WALKER'S WHITEGOODS WAREHOUSE

Frank Walker owns and operates Walker's Whitegoods Warehouse, a small business that uses the Identified Cost assignment method.

With the exception of an Inventory Loss and an Inventory Gain, the majority of transactions involving Inventory under the Identified Cost assignment method are straightforward as the actual cost of the Inventory item is included in the question.

Inventory Purchased

On 4 June 2025 Walker's Whitegoods Warehouse purchased 5 'Tilly' fridges from Ian's Imports for \$1 650 including GST each (Invoice 486).

		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							3	1 450	4 350
04/06	Inv. 486	5	1 500	7 500				3	1 450	4 350
								5	1 500	7 500

Inventory Returned to Supplier

On 6 June 2025 Walker's Whitegoods Warehouse returned 1 'Tilly' fridge to Ian's Imports and received a credit for \$1 650 (Credit Note 33).

		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							3	1 450	4 350
04/06	Inv. 486	5	1 500	7 500				3	1 450	4 350
								5	1 500	7 500
06/06	C/N. 33				1	1 500	1 500	3	1 450	4 350
								4	1 500	6 000

Inventory Sold

On 14 June 2025 Walker's Whitegoods Warehouse sold 1 'Tilly' fridge to Robert Blackwood for \$4 125 including GST (Invoice 217). This fridge cost Walker's Whitegoods Warehouse \$1 450.

ITEM: 'Tilly' Fridge		Cost method: Identified Cost Method								
SUPPLIER: Ian's Imports										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							3	1 450	4 350
04/06	Inv. 486	5	1 500	7 500				3	1 450	4 350
								5	1 500	7 500
06/06	C/N. 33				1	1 500	1 500	3	1 450	4 350
								4	1 500	6 000
14/06	Inv. 217				1	1 450	1 450	2	1 450	2 900
								4	1 500	6 000

Exam Tip: When a transaction involves Inventory used for Drawings or Advertising purposes, the same approach is used as above. The actual cost of the Inventory item will be identified in the question.

Inventory Returned by Customer

On 16 June 2025 Robert Blackwood returned the 'Tilly' fridge he purchased for \$4 125 including GST on 14 June 2025 and received a full credit (Credit Note 9). This fridge cost Walker's Whitegoods Warehouse \$1 450.

ITEM: 'Tilly' Fridge		Cost method: Identified Cost Method								
SUPPLIER: Ian's Imports										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							3	1 450	4 350
04/06	Inv. 486	5	1 500	7 500				3	1 450	4 350
								5	1 500	7 500
06/06	C/N. 33				1	1 500	1 500	3	1 450	4 350
								4	1 500	6 000
14/06	Inv. 217				1	1 450	1 450	2	1 450	2 900
								4	1 500	6 000
16/06	C/N. 9	1	1 450	1 450				3	1 450	4 350
								4	1 500	6 000

Inventory Loss

Under the FIFO cost assignment method, an Inventory Loss value is determined by using the oldest cost price in the Balance column in the Inventory card on the date of the Inventory count.

Whereas, an Inventory Loss value under the Identified cost assignment method determined by using the number of inventory items and their actual cost as revealed by an Inventory count.

On 30 June 2025 a physical inventory count confirmed there were 3 'Tilly' fridges with a cost price of \$1 450 on hand, together with 3 'Tilly' fridges with a cost price of \$1 500 on hand (Memo 18).

		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							3	1 450	4 350
04/06	Inv. 486	5	1 500	7 500				3	1 450	4 350
								5	1 500	7 500
06/06	C/N. 33				1	1 500	1 500	3	1 450	4 350
								4	1 500	6 000
14/06	Inv. 217				1	1 450	1 450	2	1 450	2 900
								4	1 500	6 000
16/06	C/N. 9	1	1 450	1 450				3	1 450	4 350
								4	1 500	6 000
30/06	Memo 18				1	1 500	1 500	3	1 450	4 350
								3	1 500	4 500

Inventory Gain

Under the FIFO cost assignment method, an Inventory Gain value is determined by using the most recent cost price in the In column of the Inventory card.

Whereas, an Inventory Gain value under the Identified cost assignment method is determined in the same way as an Inventory Loss, being their actual cost as revealed by an Inventory count.



APPLICATION EXERCISE

Rohit Sharma owns and operates Rohit's Rugs, a small business that uses the Identified cost assignment method to value its inventory.

The following transactions relates to the 'Dhawan' rug for June 2025.

05/06	Purchased 15 'Dhawan' rugs from Tonka Threads for \$660 including GST each (Invoice 175).
09/06	Sold 2 'Dhawan' rugs to Ben Folds for \$1 540 including GST each (Receipt 412). These 2 'Dhawan' rugs cost Rohit's Rugs \$600 each.
16/06	Highbett Hotels purchased 8 'Dhawan' rugs for \$13 200 including GST (Invoice 309). Five of these 'Dhawan' rugs had a cost price of \$600 and the remaining three 'Dhawan' rugs had a cost price of \$580.
18/06	Credit Note 24 issued to Highbett Hotels for the return of 3 'Dhawan' rugs and received a full credit. The 3 'Dhawan' rugs returned originally had a cost price of \$600.
20/06	Rohit's Rugs returned the 3 'Dhawan' rugs to Tonka Threads and received a full credit on their purchase from 5 June. (Credit Note 47).
30/06	A physical count determined and inventory loss of 2 'Dhawan' rugs on hand, both with a cost price of \$580 (Memo 52).

Record

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Cost Assignment Method Comparison

In order to make a comparison between the use of one cost assignment method with the other, the reporting of Inventory needs to be introduced. Outcome 2 of Unit 3 is where Income Statements are formally covered. An Income Statement reports all revenues and expenses for a period. Within the Income Statement, the profit made from the buying, selling and managing of Inventory is calculated.

An extract from an Income Statement for the month ending 31 May 2025 is presented below.

Christine's Canoes

Income Statement (extract) for the month ending 31 May 2025

	\$	\$
Revenues		
Cash Sales	4 100	
Credit Sales	21 190	
Less: Sales Returns	1 800	23 490
Less: Cost of Goods Sold		
Cost of Sales	7 830	
Freight Inwards	460	8 290
Gross Profit		15 200
Less: Inventory Loss		1 700
Adjusted Gross Profit		13 500

The focus of this section is on the value of Cost of Sales under the heading of Cost of Goods Sold and the value of the Inventory Loss reported between the Gross Profit and the Adjusted Gross Profit.

The Cost of Goods Sold represents all costs incurred in getting the Inventory into a condition or location ready for sale. The main purpose of both cost assignment methods is to allocate a cost price to each unit of Inventory sold. This value appears in the Income Statement as the Cost of Sales amount.

By subtracting all costs incurred in getting the Inventory into a condition or location ready for sale, together with the cost allocated to all units of Inventory sold in the period, from Net Sales, a Gross Profit is calculated. The Gross Profit amount represents the profit made for the period from buying and selling Inventory.

Additionally, a business may incur additional expenses during the period from simply having the Inventory in their business. This may include adjustments relating to Inventory losses as a result of a physical inventory count and Inventory write downs (covered later).

Exam Tip: Students will need to not only be able to explain the differences between the FIFO and Identified cost assignment methods, but be able to explain the effect on Reports of choosing one method in preference to the other.

Students will note that Application Exercise 5 and Application Exercise 6 use the same data but with different cost assignment methods.

A report comparison for the 'Dhawan' rug of the two methods are presented below.

Rohit's Rugs Income Statement (extract) for the month ending 30 June 2025	Application Exercise 5		Application Exercise 6		Difference
	FIFO		Identified Cost		
Revenues					
Cash Sales	2 800		2 800		
Credit Sales	12 000		12 000		
Less: Sales Returns	4 500	10 300	4 500	10 300	
Less: Cost of Goods Sold					
Cost of Sales		4 060		4 140	
Gross Profit		6 240		6 160	
Less: Inventory Loss		1 180		1 160	
Adjusted Gross Profit		5 060		5 000	60
Rohit's Rugs Balance Sheet (extract) as at 30 June 2025					
Current Assets					
Inventory	(11 @ \$600)	6 600	(3 @ \$580) (8 @ \$600)	6 540	\$60

When a business chooses one cost assignment method over another, in times of changing cost prices, there will be a difference in the value of Inventory reported on the Balance Sheet and the value of the Cost of Sales and Inventory Loss reported in the Income Statement.

As demonstrated above, if Rohit's Rugs were to use the FIFO cost assignment method instead of the Identified cost assignment method in times of rising cost prices, both the Adjusted Gross Profit in the Income Statement and the Inventory in the Balance Sheet will be \$60 higher. This is because FIFO allocates the older, cheaper unit costs first. Therefore, Cost of Sales will be lower and Profit will be higher in the Income Statement. On the Balance Sheet, both the value of Inventory and Owner's Equity will be higher.



Alternatively, if Rohit's Rugs were to use the Identified cost assignment method instead of the FIFO cost assignment method in times of rising prices, both the Adjusted Gross Profit in the Income Statement and the Inventory in the Balance Sheet will be \$60 lower.

Exam Tip: Accounting is all about opposites! If cost prices are falling, under FIFO, Cost of Sales would be higher and Profit will be lower in the Income Statement. On the Balance Sheet, both the value of Inventory and Owner's Equity will be lower.

INVENTORY VALUATION

The purchases of Inventory examples introduced in the Inventory cards provided the cost price of Inventory to be recorded in the In column. However, the cost price of an Inventory item may not necessarily just be the unit price charged by the supplier.

Cost of Inventory

The cost of inventory shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventory to their present location and condition.

However, just because a cost is incurred in bringing the Inventory to its present location and condition does not necessarily mean that it will be included in the cost price of an Inventory item.

Exam Tip: The VCE Accounting course requires students to distinguish between product and period costs in relation to inventory valuation. Students are often presented with an Invoice relating to a purchase of inventory and determine the cost price of inventory by choosing which costs are product costs and which costs are period costs.

Product Costs

A product cost is a cost incurred in getting the inventory into a condition or location ready for sale and can be directly allocated to each individual unit on a logical basis. Apart from the inventory unit price charged by the supplier, examples of product costs include modifications, import duties, protective packaging and cartage inwards or freight inwards.

Exam Tip: Even though Cartage Inwards or Freight Inwards are costs incurred in getting the Inventory into a location ready for sale, when multiple lines of inventory are delivered, the delivery cost cant be directly allocated to each individual unit of inventory and would be treated as a period cost.

A product cost is included in the unit cost of an Inventory item, is recorded in the In column of the Inventory card and debited to the Inventory General Ledger account.

A product cost is only reported in the Income Statement under the heading of Cost of Goods Sold as Cost of Sales in the period when the item of Inventory is sold.

Period Costs

A period cost is a cost incurred in getting the inventory into a condition or location ready for sale but cannot be directly allocated to each individual unit as there is no logical basis to do so. Examples of period costs include insurance on delivery and cartage inwards or freight inwards when multiple lines of inventory are delivered.

A period cost is not included in the unit cost of an Inventory item, but rather debited to its own General Ledger account and reported separately in the Income Statement under the heading of Cost of Goods Sold in the period the expense is incurred.

Exam Tip: When an additional Inventory cost is treated as a product cost instead of a period cost, Profit will be higher as Cost of Good Sold will be lower when not all of the Inventory items are sold. As accounting is all about opposites, when an additional Inventory cost is treated as a period cost instead of a product cost, Profit will be lower as Cost of Goods Sold will be higher. Even though these are good explanations, students need to go a step further and explain why Profit would be higher or lower. Cost of Goods Sold would be lower and Profit higher under product costing as it is only when the unit of Inventory is sold that the additional Inventory cost is reported as Cost of Sales under the heading of Cost of Goods Sold. Whereas, under period costing, Cost of Goods Sold would be higher and Profit lower as the entire additional inventory cost is included in the Income Statement in the period it is incurred, regardless of the number of Inventory items actually sold.

Beyoncé's Bikes

Beyoncé Knowles owns and operates Beyoncé's Bikes, a small business selling children's bikes and bike related accessories.

The following document was found in the offices of Beyoncé's Bikes.

CARTER'S			
Date: 25/06/25		Tax Invoice: 2884	
Charge to: Beyoncé's Bikes			
Item	Qty	Unit Cost	\$
'Ivy' Bike (Frame only, no tyres)	15	360	5 400
'Rumi' Bike (Frame only, no tyres)	20	420	8 400
'Brooklyn' Custom Tyres (Pairs)	35	80	2 800
'Tribeca' Helmet	8	55	440
Freight Inwards			<u>210</u>
			17 250
			<u>GST 1 725</u>
			Total Owing 18 975

a. With reference to Invoice 2884, explain the difference between a product cost and a period cost.

Both product costs and period costs are costs incurred in getting inventory into a condition or location ready for sale. A product cost, such as the 'Brooklyn' custom tyres, can be directly allocated to each bike on a logical basis of \$80. Whereas a period cost, such as the freight inwards, can't be directly allocated to each unit of inventory delivered on a logical basis as multiple lines of inventory were delivered on 25 June 2025.

Exam Tip: When presented with a question about determining the cost price of a unit of inventory by applying product costing, there will generally be one additional cost which can be directly allocated to the unit of inventory on a logical basis and therefore treated as a product cost. It is recommended that when justifying an additional cost as a product cost, students should state that it is a 'product cost' and include the per unit cost. Similarly, there will generally be one additional cost which is unable to be directly allocated to the unit of inventory on a logical basis and therefore treated as a period cost.

b. Explain the effect on profit in June 2025 if Beyoncé’s Bikes uses product costing instead of period costing.

If Beyoncé’s Bikes uses product costing instead of period costing, Cost of Goods Sold would be lower and Profit would be higher when not all of the items purchased have been sold. Product costing includes these additional costs in the unit cost of Inventory on the Balance Sheet. It is only when the unit of Inventory is sold that the product cost is reported in the Income Statement under the heading of Cost of Goods Sold as Cost of Sales. Whereas, under period costing, these additional costs are reported in the Income Statement under the heading of Cost of Goods Sold in the period the expense was incurred, regardless of the quantity of units sold.

Exam Tip: Students need to be mindful when answering an effect on profit question that month in the question (June 2025) is the same as the month on the invoice. When this is the case, students can use a prepared response as these questions are common. However, if the month in the question is the month after the month on the invoice, the opposite response is required.

Benge’s Boutique Bedding

The following document was found in the offices of Benge’s Boutique Bedding relating to its recent purchase of bed frames from Lithuania.

WAISLITZ			
Date: 28/06/25		Tax Invoice: 1978	
Charge to: Benge’s Boutique Bedding			
Item	Qty	Unit Cost	\$
'Cozzo' Bed Frame	8	180	1 440
'Franco' Bed Frame Junior	14	90	1 260
'Franco' Bed Frame Adult	10	170	<u>1 700</u>
			4 400
Import Duties (5% on cost)			220
Cartage Inwards			<u>860</u>
			5 480
		<u>GST (10%)</u>	<u>548</u>
		Total Owing	6 028
Terms 2/7,n/30			

a. Using product costing, record the details from Invoice 1978 in the Journals provided. A narration is not required.

General Journal

Date	Details	Debit	Credit
28/06	Inventory	4 620	
	Cartage Inwards	860	
	GST Clearing	548	
	Accounts Payable		6 028

b. Explain the effect on profit in July if Bengé’s Boutique Bedding uses period costing instead of product costing.

If Bengé’s Boutique uses period costing instead of product costing, Profit in **July** would be higher and Cost of Goods Sold would be lower. Period costing requires the import duties to be expensed in the period in which they are incurred (June) regardless of the number of frames sold. As these import duties have already been expensed in the Income Statement in June, when the frames are sold in July, the Cost of Goods Sold would only report the cost price of the frames that have been sold. Therefore, Cost of Goods Sold will be lower and profit will be higher in July.

APPLICATION EXERCISE

Padma’s Pots

The following document was found in the offices of Padma’s Pots.

<i>CREATIVE CLAYS</i>			
<i>Date: 29/06/19</i>		<i>Tax Invoice: 2461</i>	
<i>Charge to:</i>			
<i>Item</i>	<i>Qty</i>	<i>Unit Cost</i>	<i>\$</i>
<i>Ceramic Capsule</i>	<i>15</i>	<i>30</i>	<i>450</i>
<i>Pine Planter</i>	<i>20</i>	<i>40</i>	<i>800</i>
<i>Tunisia Tub</i>	<i>25</i>	<i>60</i>	<i><u>1 500</u></i>
			<i>2 750</i>
<i>Packaging</i>	<i>60</i>	<i>3</i>	<i>180</i>
<i>Cartage Inwards</i>			<i><u>70</u></i>
			<i>3 000</i>
			<i><u>GST (10%) 300</u></i>
			<i>Total Owing 3 300</i>
<i>Terms: 2/7, n/30</i>			

a.

A narration is not

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Lower of Cost and Net Realisable Value (NRV)

Inventory is recorded in the General Journal and the Inventory Card at its cost.

However, Inventory can be reported on the Balance Sheet at the lower of cost and net realisable value.

Net realisable value is the estimated selling price (excluding GST) in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.

Exam Tip: The VCE Accounting course describes the estimated costs necessary to make the sale as marketing, selling and distribution costs. When calculating the net realisable value of an item of inventory, students need to read the question carefully to note the quantity of promotional or marketing items included as incentives for customers. For example, one free shirt compared with two free shirts will impact on the calculation of an inventory's net realisable value.

Stephens' Suits

Martin Stephens owns and operates a men's fashion store called Stephens' Suits.

A physical inventory count confirmed that Stephens' Suits had 7 'S Club' suits on hand as at 30 June 2025.

Even though each of these suits cost Stephens' Suits \$480 plus GST, Martin has decided to reduce their selling price from \$990 including GST to \$495 including GST (memo 147).

Martin has decided that a free tie will be given away with each 'S Club' suit sold. These ties cost Stephens' Suits \$22 including GST each.

The net realisable value of a 'S Club' suit will be the reduced estimated selling price (excluding GST) of \$450 *less* **\$430.**

Value on Inventory Card	Net Realisable Value	Difference
\$480	\$430	\$50

Exam Tip: Some students confuse the topics of product costing and the calculation of the net realisable value. Product costing adds additional costs incurred in getting an inventory item into a condition or location ready for sale when it can be directly allocated on a logical basis. Whereas, the calculation of a unit of inventory's net realisable value involves subtracting any additional costs necessary to make the sale.

A comparison shows that the Net Realisable Value is \$50 less than the \$480 value recorded on the Inventory Card.

Therefore, according to the qualitative characteristic of faithful representation, an adjustment to the value of Inventory to be reported on the Balance Sheet as at 30 June 2025 is required to ensure that the financial statements represent real economic events and that the information reported is complete, free from error and without bias. As the business realises that they will not be able to sell a particular line or unit of inventory for more than its cost price, the value of inventory reported on the Balance Sheet would be overstated and not complete.

Likewise, the qualitative characteristic of relevance requires that information capable of making a difference to the decisions made by users is to be included in financial statements. As the business realises that they will not be able to sell a particular line or unit of inventory for more than its cost price, an Inventory Write Down expense adjustment is required to represent the loss that had occurred in the current period so that profit will not be overstated.

Exam Tip: Students are required to confirm the quantity of inventory on hand via a physical inventory count before applying the lower of cost and net realisable value rule. This is crucial when students are presented with both the quantity appearing on the inventory card and the actual quantity as per the physical inventory count. A common error occurs when students are required to calculate the value of the Inventory Write Down or record an adjustment in the General Journal. Students may calculate the net realisable value correctly, but apply this value to the quantity as per the inventory card rather than the quantity as per the inventory count.

Recording Inventory Write Down

A general journal entry is required on 30 June 2025 in relation to the 'S Club' suit as the net realisable value has fallen below the cost price appearing on the inventory card. The \$50 difference is multiplied by the quantity of 'S Club' suits on hand confirmed by the physical inventory count.

General Journal

Date	Details	Debit	Credit
30/06	Inventory Write Down	350	
	Inventory		350
	7 'S Club' suits written down to NRV (Memo 147).		

Exam Tip: The narration in the above General Journal entry includes the quantity of inventory items, the type of inventory item and the source document. If a reason for the inventory's net realisable value falling below its cost price is provided in the question, it should be included in the narration. Reasons include damage, out of fashion or season or has been superseded by a new model.

ITEM: 'S Club' Suit		Cost method: First In, First Out Method								
SUPPLIER: Renmark		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							9	480	4 320
04/06	Rec. 1341				1	480	480	8	480	3 840
30/06	Memo 146				1	480	480	7	480	3 360
30/06	Memo 147				7	50	350	7	430	3 010

EFFECT OF TRANSACTION ON ACCOUNTING EQUATION

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Inventory	Decrease	\$350
Liabilities		No Effect	\$0
Owner's Equity	Net Profit (Inventory Write Down)	Decrease	\$350

Exam Tip: When asked to explain the effect of an Inventory Write Down on an Accounting report, students are reminded of the 'two-fold' effect of transactions. For example, the effect of an Inventory Write Down on the Balance Sheet not only decreases the value of Assets (Inventory) but it also decreases the value of Owner's Equity (Profit). Alternatively, the effect of an Inventory Write Down on an Income Statement increases Inventory Write Down expense but also decreases Profit.

Reporting Inventory Write Down

Stephen's Suits Income Statement (extract) for the month ending 30 June 2025

	\$	\$
Revenues		
Cash Sales	8 090	
Credit Sales	3 460	
Less: Sales Returns	480	11 070
Less: Cost of Goods Sold		
Cartage Inwards	310	
Cost of Sales	4 170	4 480
Gross Profit		6 590
Less: Inventory Loss	690	
Less: Inventory Write Down	350	1 040
Adjusted Gross Profit		5 550

Sandy's Sofas

Sandy Olson owns and operates Sandy's Sofas, a small business selling a wide range of home furniture including couches, dining packages and display cases.

The Inventory card for the 'Frenchie' sofa as at 30 June 2025 appears as follows.

ITEM: 'Frenchie' Sofa		Cost method: First In, First Out Method								
SUPPLIER: Sustain		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
30/06	Balance							1	1 050	1 050
								2	1 085	2 170

Additional Information:

Sandy has decided to reduce the selling price of the 'Frenchie' sofa from \$2 310 including GST to \$990 including GST (Memo 208).

As an incentive for her staff, Sandy will give the employee who sells a 'Frenchie' sofa a \$50 bonus payment.

Sandy will also provide free home delivery for each 'Frenchie' sofa sold. Each of these deliveries cost Sandy's Sofas \$80 plus GST.

a. Calculate the Net Realisable Value of one 'Frenchie' sofa.

Estimated Selling Price	\$900
Less: Bonus Payment	\$50
Less: Delivery Fee	<u>\$80</u>
	\$770

b. Update the 'Frenchie' sofa Inventory card as a result of the additional information.

ITEM: 'Frenchie' Sofa		Cost method: First In, First Out Method								
SUPPLIER: Sustain		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
30/06	Balance							1	1 050	1 050
								2	1 085	2 170
30/06	Memo 208				1	280	280			
					2	315	630	3	770	2 310

APPLICATION EXERCISE

Oliver's Ovens

Oliver Clayton owns and operates Oliver's Ovens, a small business that uses the perpetual method of inventory recording and the First In, First Out (FIFO) method of assigning cost are used.

The Inventory card for the 'Wainer' Oven appears as follows.

ITEM:		Cost method:								
SUPPLIER:		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
30/06	Balance							1	860	
								5	780	4 760

Oliver decided to reduce the selling price of the 6 'Wainer' ovens on hand from \$2 365 including GST to \$770 including GST (Memo 197). In order to sell the remaining ovens, Oliver will give each customer who buys a 'Wainer' oven a free cookbook. The cookbook cost Oliver's Ovens \$44 including GST.

a. Prepare the General Journal entry required on 30 June 2019 relating to the 'Wainer' oven.

A narration is

Analysis of Business Performance

The most obvious way to assess a business' trading performance for a period would be to look at the profit (or loss) reported in the Income Statement. As will be introduced in Outcome 2 of Unit 3, an Income Statement will report the revenues earned and expenses incurred for a period. In pure dollar terms, this will enable users of the Income Statement to see if the business' profit was higher or lower than the previous period.

Alternatively, the Cash Flow Statement, also introduced in Outcome 2 of Unit 3, reports a summary of all cash inflows and cash outflows for a period. This will enable users to assess the sources and uses of the business' cash.

However, a thorough analysis of business performance examines changes and trends involving a combination of both financial and non-financial indicators.

The VCE Accounting Study Design provides twelve financial indicators students can use to measure business performance in relation to profitability, liquidity and stability.

Profitability compares the profit the business makes to a base figure such as sales, capital or assets and is generally expressed as a percentage.

Liquidity measures the ability of a business to meet its short-term debts as they fall due.

Stability measures the ability of a business to meet its debts and continue its operations in the long term.

Exam Tip: It is crucial that students know these definitions of profitability, liquidity and stability and incorporate them in their responses. For example, Outcome 1 of Unit 3 will focus on how three financial indicators will effect the liquidity of a business. In formulating a response, students will need to explain whether the trend in the financial indicator(s) in a question will make it easier or more difficult for the business to meet their short term debts as they fall due., i.e. the liquidity of the business.

The analysis of a business' performance generally involves comparing the result of the current period to one of four **benchmarks**:

1. Previous period
2. Budget
3. Industry average
4. Alternative investments

The purpose of a benchmark is to provide a point of comparison when reviewing business performance.

Exam Tip: Students need to know these four benchmarks. However, the alternative investment benchmark is only used to assess the Return on Owner's Investment profitability indicator. That leaves the first three benchmarks from the above list. A common examination question is to ask students to state one other benchmark a business owner can use to assess the profitability or liquidity of the business. A common error students make when answering this question is that they 'group' together the 12 financial indicators into either profitability or liquidity and provide one of the 12 financial indicators not used in the question. The other error students make is that they ignore the word 'other' in the question and provide the same benchmark that has already been provided in the question. For example, a question that provides the results of a financial indicator for 2019, 2018 and 2017 can only have two acceptable answers - either budget or industry average.

The three non-financial indicators of Unit 3 Outcome 1 are the Inventory Turnover, the Accounts Receivable Turnover and the Accounts Payable Turnover.

Exam Tip: Students are required to explain how the trends in the Inventory Turnover, the Accounts Receivable Turnover and the Accounts Payable Turnover will either, positively or negatively, effect primarily the liquidity, and sometimes the profitability, of a business.

INVENTORY TURNOVER

The Inventory Turnover measures the average number of days it takes for a business to sell its inventory.

The Inventory Turnover formula is as follows:

$$\frac{\text{Average Inventory}}{\text{Cost of Goods Sold}} \times 365$$

The Inventory Turnover is expressed as 'number of days' with changes being described as faster or slower. Generally, the fewer number of days the more favourable for the business as, by selling inventory faster, it will assist it earn profit and convert the inventory into cash. Alternatively, an increase in the number of days is generally unfavourable for the business as, by selling inventory slower, it limits its ability to earn profit and convert the inventory into cash.

Exam Tip: There have been no marks allocated in exams for students to calculate any of the financial indicators. However, students should be familiar with each of the twelve financial indicators in order to provide explanations as to why the indicators have changed. When commenting on these three turnover financial indicators, students need to use the words faster, slower, favourable and unfavourable.

Impact on Liquidity

Liquidity measures the ability of a business to meet its short-term debts as they fall due.

If the inventory turnover is faster (reduction in the number of days) it is favourable for the liquidity of the business as it is selling its inventory faster. By converting the inventory to cash faster it makes it easier for the business to meet its short-term debts as they fall due.

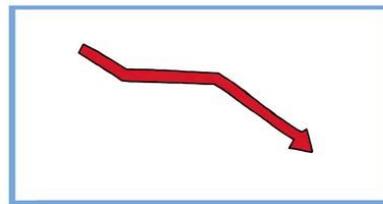
Alternatively, if the inventory turnover is slower (increase in the number of days) it is unfavourable for the liquidity of the business as it is taking longer to sell. By converting the inventory to cash slower it makes it more difficult for the business to meet its short-term debts as they fall due.

Impact on Profitability

Profitability compares the profit the business makes to a base figure such as sales, capital or assets and is generally expressed as a percentage.

If the inventory turnover is faster (reduction in the number of days) it is generally favourable for the profitability of the business as it is selling its inventory faster. By increasing the quantity of units of inventory sold, the business would report an increase in Sales and probably an increase in profit and therefore profitability.

However, a faster inventory turnover may not necessarily be favourable for the profitability of the business. Due to a reduction in its mark-up percentage, the cheaper selling prices result in less profit being made for each unit of inventory sold. As less profit is being made for each unit of inventory sold, the profit, and possibly the profitability of the business, would be worse. Another strategy that could have been adopted to improve the inventory turnover is to reduce the quantity and value of inventory on hand by buying inventory in smaller quantities more frequently. However, the business exposes itself to potentially running out of inventory and losing potential sales, and incurring higher transportation expenses which would negatively affect both profit and profitability.



“What if we don’t change anything at all ... and something magical just happens.”

Exam Tip: The above explanation of the impact of a faster inventory turnover on the profitability of a business is a good example of a 'discuss' style question. When students are asked to 'discuss' the trend of a financial indicator on either the liquidity or profitability of a business, an explanation requires students to address both the potential positive and negative impacts.

Alternatively, if the inventory turnover is slower (increase in the number of days) it is unfavourable for the profitability of the business as it is taking longer to sell. If the quantity of units sold has decreased, the business would report a decrease in Sales probably a decrease in profit and therefore profitability. An additional potential negative impact of a slower inventory turnover would be that inventory is remaining in the business longer. The longer the inventory remains in the business, the more likely it is to be obsolete and the business recording an inventory write-down.

However, a slower inventory turnover may not necessarily be unfavourable for the profitability of the business. Due to an increase in its mark-up percentage, the higher selling prices result in more profit being made for each unit of inventory sold. As more profit is being made for each unit of inventory sold, the profit, and possibility the profitability of the business, could be better. Another strategy that could have contributed to the worse inventory turnover was to increase the quantity and value of inventory on hand by buying inventory in larger quantities less often. The reason why the business decided to buy inventory in larger quantities maybe due to a cheaper unit cost. Not only would transportation expenses reduce, but in the event that selling prices remained constant, the business would be making more profit from each unit of inventory sold.

Exam Tip: Strategies to improve financial indicators are a key part of the VCE Accounting course. Not only do students need to know multiple strategies to improve each of the twelve financial indicators, they need to be able to justify why the strategies chosen will improve the indicator.

Strategies to Improve the Management of Inventory

- employ strategies to increase sales, like advertising, changing selling prices (changing the mark up), or changing the inventory mix
- decreasing the level of inventory on hand by ordering less, ordering smaller amounts more frequently, replacing slow moving inventory lines
- reducing the selling price of slow-moving items
- relocating inventory within the store to highlight particular goods

A justification for these strategies is to ultimately sell more inventory faster or to reduce the quantity and value of inventory to mathematically improve the inventory turnover.

ACCOUNTS RECEIVABLE TURNOVER

The Accounts Receivable Turnover measures the average number of days it takes for a business to collect outstanding debt balances from credit customers.

The Accounts Receivable Turnover formula is as follows:

$$\frac{\text{Average Accounts Receivable}}{\text{Net Credit Sales (plus GST)}} \times 365$$

The Accounts Receivable Turnover is expressed as 'number of days' with changes being described as faster or slower. Generally, the fewer number of days the more favourable for the business as, by collecting outstanding debt balances from credit customers faster, the business has access to the cash faster. Alternatively, an increase in the number of days is generally unfavourable for the business as, by taking longer to collect outstanding debt balances from credit customers slower, it increases the likelihood of the debt becoming irrecoverable.

Exam Tip: When it comes to assessing the trend in the Accounts Receivable Turnover, a comparison needs to be made to the credit terms. Generally, when the number of days is fewer (faster) it is beneficial for the liquidity. Alternatively, when the number of days is more (slower) it is worse for the liquidity of the business. Even if the number of days is fewer, if the number of days still remains outside the credit terms, even if the trend is favourable, the outcome remains unfavourable.

Strategies to Improve the Management of Accounts Receivable

- offer a discount / increase the discounts offered
- sending reminders to credit customers / monthly statements
- threatening not to provide credit in the future
- employing a debt collector
- taking legal action to recover the outstanding amount

The justification of using these strategies is to provide the credit customer with an incentive to pay their amount owing promptly or to remind the credit customer to pay their amount owing.

Exam Tip: The identification of the credit terms during reading time is crucial. Students asked to suggest a new strategy to improve the management of outstanding Accounts Receivable balances, a common suggestion is to offer a discount. However, if the business already offers a discount for prompt payment, a correct suggestion would be to increase the discount offered.

However, offering or increasing the discount offered would negatively affect the profitability of the business. Any increase in discount expense would decrease net profit. Similarly, sending reminders to credit customers, employing a debt collector or taking legal action comes at a cost. Not only is this a timely process, but the costs associated with employing additional staff or initiating legal proceedings need to be measured against the amount being recovered.

ACCOUNTS PAYABLE TURNOVER

The Accounts Payable Turnover measures the average number of days it takes for a business to repay their outstanding Accounts Payable balances.

The Accounts Payable Turnover formula is as follows:

$$\frac{\text{Average Accounts Payable}}{\text{Net Credit Purchases (plus GST)}} \times 365$$

The Accounts Payable Turnover is expressed as 'number of days' with changes being described as faster or slower.

The trend in the Accounts Payable Turnover is another example of accounting being all about opposites, especially when compared to the interpretation of the Accounts Receivable Turnover.

As long as the credit terms offered by a supplier are not exceeded, the more number of days (slower) it takes to repay an outstanding Accounts Payable balance the better it is for the liquidity of the business. When a payment made to a supplier is delayed, but not beyond the credit terms offered, cash is within the business for a longer period of time, making it easier for the business to meet its **other** short-term debts as they fall due.

A consequence of exceeding the credit terms of a supplier is having the ability to purchase inventory on credit removed. This will have a negative impact on



liquidity as the business will be required to purchase inventory using cash. This will result in significant amounts of cash leaving the business making it difficult for the business to meet **other** short-term debts as they fall due.

Alternatively, the fewer the number of days (faster) it takes to repay an outstanding Accounts Payable balance the worse it is for the liquidity of the business. When a payment is made to a supplier well within the credit terms offered, cash is leaving the business before it is necessary, making it more difficult for the business to meet its **other** short-term debts as they fall due.

Strategies to Improve the Management of Accounts Payable

Strategies to improve the management of accounts payable is to either pay the amount owing on, or as close to the due date as possible. Alternatively, if a business' liquidity permits, pay within the credit terms offered to be entitled to a discount for prompt payment.

Exam Tip: A common examination question involves either a visual representation or a table of results of the Inventory Turnover, Accounts Receivable Turnover and the Accounts Payable Turnover. Not surprisingly, students are asked to explain the effect on the liquidity of the business when the Inventory Turnover and Accounts Receivable Turnover are slower, yet the Accounts Payable Turnover is faster. Trends to look for include whether the Accounts Receivable Turnover still exceeds the credit terms and whether the Accounts Payable Turnover is faster, but not fast enough to be entitled to a discount.

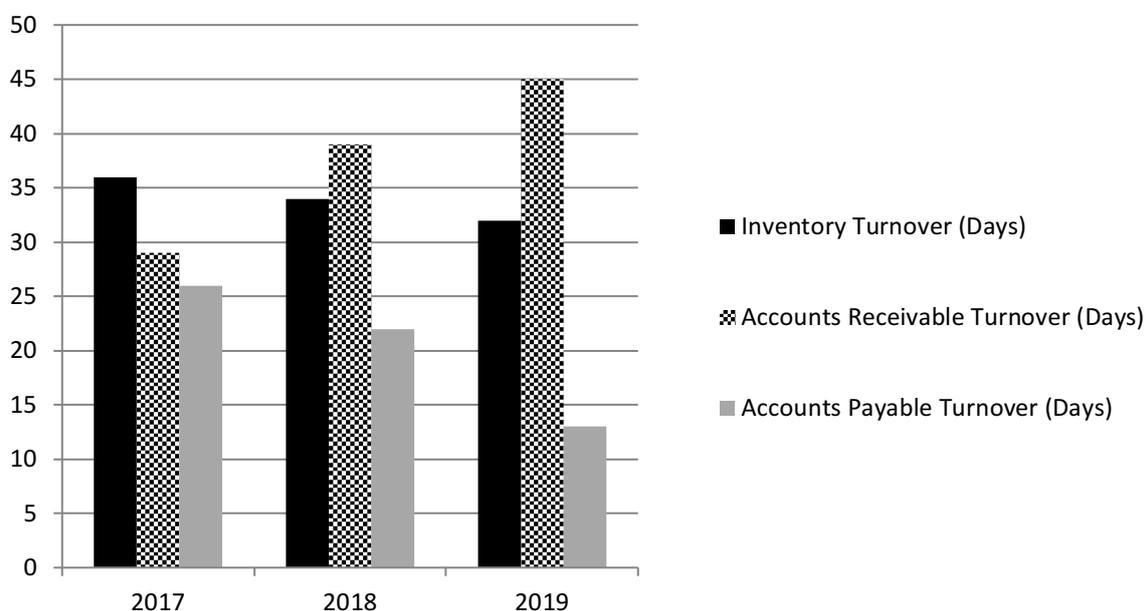
APPLICATION EXERCISE

Holly's Hats

Holly's Hats requires its Account Receivable customers to pay within 30 days of sale and offers a 2 per cent discount if they pay within 7 days.

Holly's Hats has negotiated with their supplier credit terms of 21 days and receives a 2 per cent discount if they are paid within 7 days.

The accountant of Holly's Hats has presented the following trends.



Discuss whether the liquidity of Holly's Hats has improved or worsened between 2017 and 2019.

Download templates to complete all Application Exercises at <https://www.commpap.com/page90-2/>

ETHICAL CONSIDERATIONS WHEN OPERATING A TRADING BUSINESS

In all consultations and communications, accountants are required to be maintain their integrity, impartiality, objectivity and confidentiality.

The focus of the VCE Accounting course are the ethical considerations involved in decisions made by owners of trading businesses, not accountants.

The business decisions made by the owner will not only be influenced by financial considerations but also by other ethical considerations including those which are social and environmental in nature. Any decision made by the owner should also have the reputation of the business in mind.

For example, the removal of plastic bags by both Coles and Woolworths were decisions made with the environmental impact of their disposal in mind. Similarly, restaurants and cafes have chosen to use paper straws in preference to plastic straws.

Trading businesses should also consider how ethical their suppliers are in sourcing their materials, the treatment of their employees and their waste management policies.

Other examples include marketing, adoption of sales techniques and privacy considerations, especially given the popularity of social media.

Exam Tip: Ethical considerations are new to the VCE Accounting course. Students should be able to explain that ethical considerations involve both the social and environmental impact. Further to this, students should have examples to provide to demonstrate their understanding of what it means for a business to act ethically.

MINI EXAM NO 1: UNIT 3 AREA OF STUDY 1 (50

Question 1 (18 marks)

Oscar Mayer owns and operates Mayer's Mattresses, a small business that applies a fixed mark-up of 150%.

The following transactions for the second half of February 2025 appear as follows.

16/02	Advertising of \$1 500 plus GST paid. (EFT 7865)
18/02	20 'Bamboo' mattresses purchased from a new supplier – Sustain – for \$440 including GST each (Invoice 3). Sustain offered Mayer's Mattresses credit terms of 2/7, n/30.
20/02	Receipt 914 issued to Lang Hotels for the \$7 500 received to be deducted from their amount owing.
20/02	The Australian Taxation Office was paid the \$1 278 GST Clearing balance owing from January 2025. (Bank Statement)
21/02	Mayer's Mattresses returned 5 'Bamboo' mattresses to Sustain and received a full credit (Credit Note 1).
23/02	Oscar took two 'Sleep EZY' large mattresses for his beach house (Memo 64). The 'Sleep EZY' large mattress sells for \$935 include GST.
24/02	Sustain were paid the outstanding account balance. (EFT 1187)
29/02	Wages of \$1 800 were paid. (EFT 8892)

- a. Prepare the General Journal entries required to record each transaction. 13 marks
Narrations are not required.
- b. Explain one ethical issue Oscar should consider when choosing to purchase inventory from a new supplier. 2 marks

- c. Explain how the GST Clearing balance owing to the Australian Taxation Office would have been classified on the Balance Sheet of Mayer's Mattresses as at 31 January 2025. 3 marks

Question 2 (11 marks)

Dustin Brown owns and operates Brown's Blankets.

Dustin uses the FIFO (First In, First Out) cost assignment method.

The following transactions relate to the 'Red Tartan' blanket for March 2025.

05/03	Purchased 20 'Red Tartan' blankets from McClennan's for \$990 including GST (Invoice 829).
08/03	Sold 3 'Red Tartan' blankets to Avita Homes for \$110 including GST each (Receipt 637).
16/03	The MCC purchased 12 'Red Tartan' blankets for \$1 188 including GST (Invoice 395).
18/03	The MCC returned 4 'Red Tartan' blankets and were issued a full credit (Credit Note 13).
27/03	Brown's Blankets returned the 4 'Red Tartan' blankets to McClennan's and received a full credit (Credit Note 34).
31/03	A physical count determined an inventory loss of 1 'Red Tartan' blanket (Memo 61).

- a. Explain why Brown's Blankets would use the FIFO cost assignment method instead of the Identified Cost assignment method. 2 marks
- b. Record the transactions in the 'Red Tartan' blanket inventory card. 6 marks
- c. Apart from the identification of an inventory loss or inventory gain, state one benefit of using inventory cards in the management of inventory. 1 mark
- d. Explain why the value of the 'Red Tartan' blanket reported in the Balance Sheet may be higher using the FIFO cost assignment method compared to Identified cost assignment method. 2 marks

Question 3 (5 marks)

Aleisha Hall owns and operates Aleisha's Air, a small business that sells air conditioners and heaters.

The following details relate to a recent purchase of inventory.

WINKLER'S 1989 Isabelle Road AUCKLAND NEW ZEALAND 1024		Terms 2/7, n/30	
23 April 2025		INVOICE: 774	
Account Name: Aleisha's Air 40 Vortex Street GARDENVALE VIC 3185			
Qty	Product	Cost	Amount
15	'Taylor' Air Conditioner	\$1 400	\$21 000
20	'Danny' Heater	\$900	\$18 000
		Sub-Total	\$39 000
Import Duties (12% of cost)			\$4 680
		GST	\$3 900
		Total Owing	\$47 580

Upon receiving the inventory on 23 April 2025, Aleisha's Air paid \$946 including GST to Donald's Deliveries for transporting the inventory from Winkler's.

- a. Using product costing, calculate the unit cost at which the 'Taylor' air conditioner would be recorded in the inventory card. 1 mark
- b. Referring to your answer in part a. explain your treatment of the transportation costs paid to Donald's Deliveries. 2 marks
- c. Explain the effect on the Income Statement for the month ended 30 April 2025 if Aleisha's Air used period costing instead of product costing assuming not all the items are sold. 2 marks

Question 4 (7 marks)

Chantilly Tai owns and operates an online camping supplies store called Tai's Tents.

The Inventory card for the 'Survivor' tent for June 2025 appears as follows.

ITEM: 'Survivor' tent		Cost method: First In, First Out								
SUPPLIER: Country Wide										
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							5	305	1 525
								10	320	3 200
08/06	Inv.742				1	305	305	4	305	1 220
								10	320	3 200
14/06	Memo 58				1	305	305	3	305	915
								10	320	3 200
23/06	Memo 61				1	305	305	2	305	610
								10	320	3 200

A physical inventory count determined there were 11 'Survivor' tents on hand as at 30 June 2025.

Chantilly has decided to reduce the selling price of the 'Survivor' tents from \$880 including GST to \$319 including GST (memo 63).

With each 'Survivor' tent sold, Chantilly will give each customer a free inflatable mattress. These mattresses cost Tai's Tents \$15 plus GST.

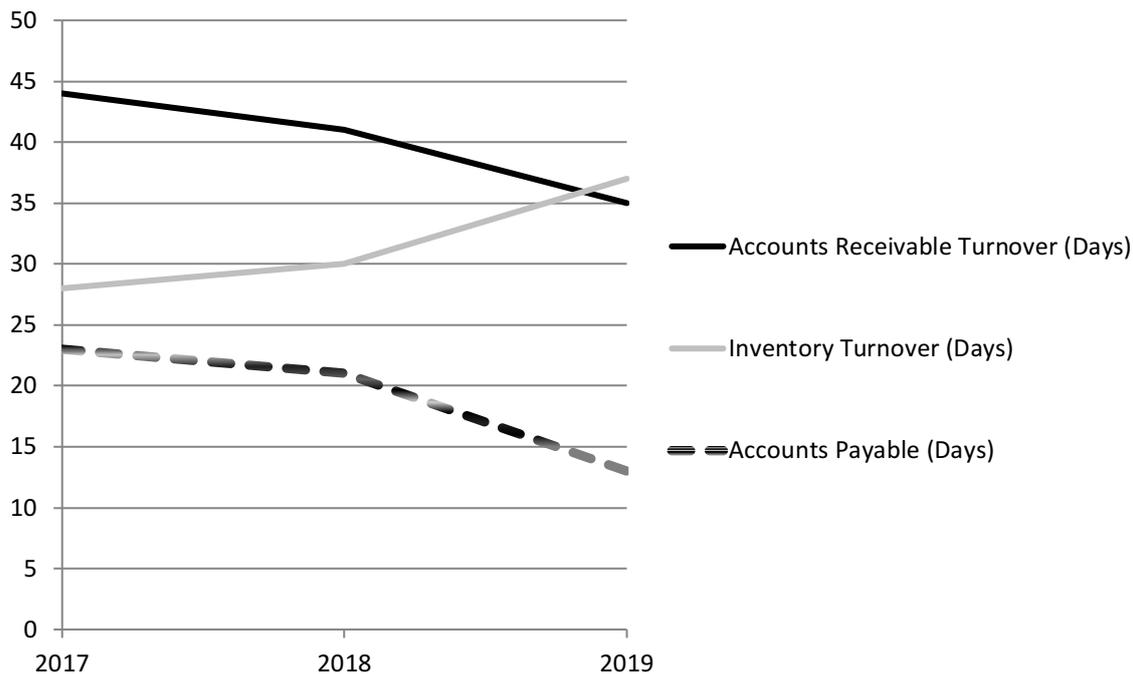
The cost paid by Tai's Tents to deliver each tent to the customer is \$20 plus GST.

- a. Calculate the Net Realisable Value of one 'Survivor' tent. 2 marks
- b. Record the General Journal entry required on 30 June 2025 in relation to the valuation of the 'Survivor' tent.
A narration **is** required. 3 marks
- c. Referring to the faithful representation qualitative characteristic, explain why a valuation adjustment is required for Inventory on 30 June 2025. 2 marks

Question 5 (9 marks)

Kevin Eubanks owns and operates Kevin’s Kites.

The accountant of Kevin’s Kites has provided the following information.



Kevin’s Kites’ customers are offered credit terms of 2/7, n/30.

Kevin’s Kites’ only supplier offers credit terms of 2/10, n/45.

- Discuss whether the liquidity of Kevin’s Kites has improved or worsened over time. 4 marks
- Explain one consequence for a business that is experiencing a decline in its liquidity. 2 marks
- State and justify one strategy Kevin could introduce to improve the Inventory Turnover. 2 marks
- State one other benchmark Kevin could use to assess the liquidity of his business. 1 mark

END OF MINI EXAM NO. 1

EXAMS



YOU BE THE ASSESSOR: UNIT 3 AREA OF STUDY 1

In this section, you are required to assess the responses presented for each of the questions. You should award the responses a score and justify your decision. Once complete, compare your assessment to that of the author provided at the CPAP website <http://www.commpap.com/page90.html>

Question 1 (2017 VCAA June Exam Question 4)

A2 Imports has provided the following partially completed Inventory Card for the Tech television.

Inventory card

ITEM: Tech television					Cost method: First In, First Out					
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/05	Balance							10	500	5 000
05/05	Inv. 234	10	550	5 500				10	500	
								10	550	10 550

Additional information

- 6 May Credit sale of eight Tech televisions to a local school for \$800 each plus GST (Invoice 430)
- 12 May Credit purchase of seven Tech televisions at a cost of \$475 each plus GST and customs duty of \$350 plus GST on this invoice (Invoice 644)
- 17 May Owner withdrew one Tech television and one Ace television from the business (Memo 33)
- 19 May Provided three Tech televisions to a local hospital in exchange for advertising in their newsletter (Memo 34)
- 24 May Customer returned one faulty Tech television to the business (Credit Note 56)



SAMPLE ANSWER A

Record the additional information in the Inventory Card provided.

5 marks

ITEM: Tech television					Cost method: First In, First Out					
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/05	Balance							10	500	5 000
05/05	Inv. 234	10	550	5 500				10	500	
								10	550	10 550
06/05					8	500	4 000	2	500	
								10	550	6 550
12/05	Inv. 644	7	475	3 325				2	500	
								10	550	
								7	475	9 875
17/05	Memo 33				1	500	500	1	500	
								10	550	
								7	475	9 375
19/05	Memo 34				1	500	500	8	550	
					2	550	1 100	7	475	7 725
24/05	C/N 56	1	500	500				1	500	
								8	550	
								7	475	8 225

Justification _____

SAMPLE ANSWER B

Record the additional information in the Inventory Card provided.

5 marks

ITEM: Tech television					Cost method: First In, First Out					
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/05	Balance							10	500	5 000
05/05	Inv. 234	10	550	5 500				10	500	
								10	550	10 550
06/05	Inv. 430				8	500	4 000	2	500	
								10	550	6 550
12/05	Inv. 644	7	525	3 675				2	500	
								10	550	
								7	525	10 175
17/05	Memo 33				1	500	500	1	500	
								10	550	
								7	525	9 675
19/05	Memo 34				1	500		8	550	
					2	550	1 600	7	525	8 075
24/05	C/N 56	1	550	550				9	550	
								7	525	8 625

Justification _____

A physical stocktake was conducted on 31 May and there were 15 Tech televisions on hand (Memo 35).

Prepare the General Journal entry required to record Memo 35.

A narration is required.

3 marks

SAMPLE ANSWER A

General Journal

Date	Details	Debit	Credit
31/05	Inventory Loss	475	
	Inventory		475

Justification _____

SAMPLE ANSWER B
General Journal

Date	Details	Debit	Credit
31/05	Inventory Loss	550	
	Inventory		550
	Inventory loss of 1 'Tech TV' per inventory count (Memo 35)		

Justification _____

A new model of the Tech television, called Tech2, was released during May 2017.

The owner provided the following information about the existing televisions in stock on 31 May 2017.

Model	Estimated selling price	Delivery to customers
Tech television	\$400	\$40

Complete the table provided to show the effect that the release of the new Tech2 television will have on the Balance Sheet.

2 marks

SAMPLE A

	Increase / Decrease / No Effect	Amount
Assets	Decrease	\$2 465
Liabilities	No Effect	\$0
Owner's Equity	Decrease	\$2 465

Justification _____

SAMPLE B

	Increase / Decrease / No Effect	Amount
Assets	Decrease	\$2 675
Liabilities	No Effect	\$0
Owner's Equity	Decrease	\$2 675

Justification _____

_____**Question 2 (2018 VCAA November Exam Question 2)**

The Sports Store sells cricket equipment. Reports are prepared annually on 30 June. At 30 June 2018, two inventory cards were incomplete as the following transactions and information had not be recorded:

- 28 June 2018 Twelve Test Cricket balls were sold to Wales Cricket Club for \$60 each plus GST (Invoice 2224).
- 29 June 2018 Six Test Cricket balls were returned to Carlson Ltd from the delivery on 5 June (Credit Note 45).

Additional information

- After these transactions were taken into account, an inventory count on 30 June 2018 showed the following:
 - Test Cricket balls – there was no stock loss or gain
 - Power Plus cricket bats – 18 were on hand, including five that were damaged (Memo 61)
- The selling price of the five damaged bats will be reduced to \$150 each plus GST. A bat cover (cost \$10 each plus GST) will be provided free of charge with each damaged bat sold. (Memo 62)

Complete the Inventory Cards.**5 marks****SAMPLE ANSWER A**

ITEM: Test Cricket balls					Cost method: First In, First Out					
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							48	30	1 440
05/06	Inv. 816	24	35	840				48	30	
								24	35	2 280
28/06	Inv. 2224				12	30	360	36	30	
								24	35	1 920
29/06	C/N. 45				6	30	180	30	30	
								24	35	1 740

ITEM: Power Plus cricket bats					Cost method: First In, First Out					
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							20	220	4 400
30/06	Memo 61				2	220	440	18	220	3 960
30/06	Memo 62				18	80	1 440	18	140	2 520

Justification _____

SAMPLE B

5 marks

ITEM: Test Cricket balls					Cost method: First In, First Out					
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							48	30	1 440
05/06	Inv. 816	24	35	840				48	30	
								24	35	2 280
28/06	Inv. 2224				12	30	360	36	30	
								24	35	1 920
29/06	C/N. 45				6	35	210	36	30	
								18	35	1 710

ITEM: Power Plus cricket bats					Cost method: First In, First Out					
		IN			OUT			BALANCE		
Date	Document	Quantity	Cost	Total	Quantity	Cost	Total	Quantity	Cost	Total
01/06	Balance							20	220	4 400
30/06	Memo 61				2	220	440	18	220	3 960
30/06	Memo 62				5	80	400	5	140	
								13	220	3 560

Justification _____

Question 3 (2013 VCAA Exam Question 3)

DAB Sports has recently added scooters to its product range. The scooters are imported from Indonesia along with several other stock items.

DAB Sports prepares reports annually on 30 June.

Details of the first shipment of scooters in May 2013 are shown below.

Item	Quantity	Cost	Total
Trail bikes	60	\$130	\$7 800
Soccer balls	100	\$16	\$1 600
Scooters	50	\$60	<u>\$3 000</u>
		Total	\$12 400
Delivery charges			<u>\$ 2 100</u>
Total invoiced amount			<u>\$14 500</u>

Additional information

- Customs duty of 15% was paid on all goods.
- GST was paid based on cost plus customs duty.
- GST is not payable on the delivery charges.
- The scooters will be rebadged in Australia with DAB Sports logos at a cost of \$2 per scooter (plus GST) before being ready for sale.

Calculate the unit cost at which the scooters should be recorded in the Inventory Card.

2 marks

SAMPLE ANSWER A

Invoice Price	\$60
Plus: Delivery Charges	\$10
Plus: Customs Duties	\$9
Plus: Rebadging (Logos)	<u>\$2</u>
	\$81

Justification _____

SAMPLE ANSWER B

Invoice Price	\$60
Plus: Customs Duties	\$9
Plus: Rebadging (Logos)	<u>\$2</u>
	\$71

Justification _____

Explain your treatment of the following items when determining the unit cost of the scooters.

- **Rebadging cost**
- **GST**

3 marks

SAMPLE ANSWER A

The rebadging costs (logos) were treated as a product cost and included in the unit cost of the scooters as it was a cost incurred in getting the scooters into a condition ready for sale.

Whereas, the GST is not included in the unit cost of the scooters as it is not a product or period cost incurred in getting the scooters into a condition or location ready for sale. Rather, the GST reduces the GST liability of the business as it is recorded as a debit entry to the GST Clearing account instead of being included in the Inventory amount reported on the Balance Sheet or reported as an expense under the heading of Cost of Goods Sold in the Income Statement.

Justification _____

SAMPLE ANSWER B

The rebadging costs (logos) were treated as a product cost and included in the unit cost of the scooters as it was a cost incurred in getting the scooters into a condition ready for sale which can be directly allocated to each scooter on a logic basis of \$2 per scooter.

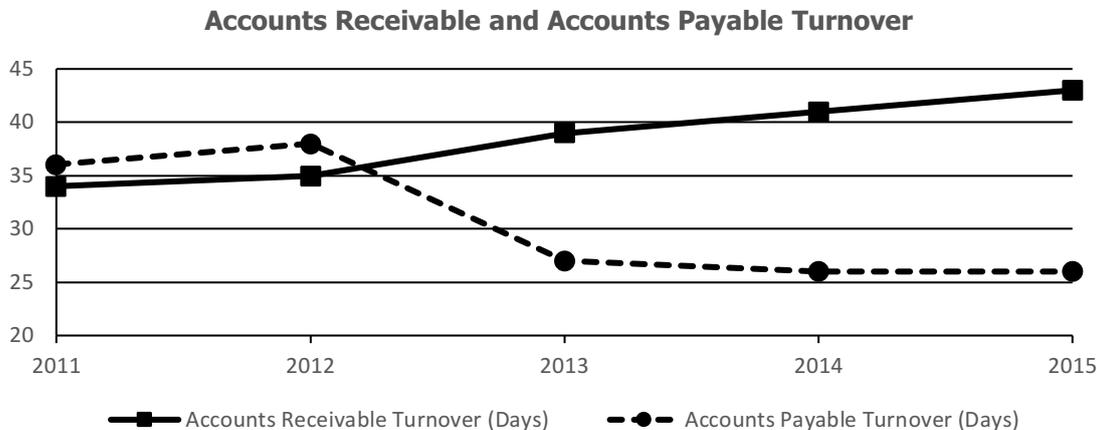
Whereas, the GST is not included in the unit cost of the scooters as it is not an expense of the business. Rather, the GST reduces the GST liability of the business as it is recorded as a debit entry to the GST Clearing account instead of being included in the Inventory amount reported on the Balance Sheet or reported as an expense under the heading of Cost of Goods Sold in the Income Statement.

Justification _____

Question 4 (2015 VCAA Exam Question 6)

The owner of Brant’s Vending Machines is concerned that the business is frequently short of cash and has to draw on its bank overdraft on a regular basis. All purchases and sales are made on credit. Credit terms are n/30 for accounts payable and 5/14, n/30 for accounts receivable.

The accountant provided the following graph to illustrate one factor causing this cash shortage.



Discuss strategies that the business could implement to overcome the problem.

6 marks

SAMPLE ANSWER A

The slower Accounts Receivable Turnover combined with the faster Accounts Payable Turnover will have a negative effect on the liquidity of the business as they will have less cash available to meet all their short-term debts as they fall due. As the business is waiting longer to collect cash from their outstanding Accounts Receivable balances but paying their outstanding Accounts Payable balances earlier than required, the business will be required to use all their cash available, including using its bank overdraft facility.

One strategy the business could implement to overcome the problem would be to offer discounts to their credit customers. This would act as an incentive for credit customers to pay their outstanding balances which would hopefully lead to a faster Accounts Receivable Turnover.

Another strategy the business could implement to overcome the problem would be to review their credit facilities. This may involve removing credit facilities altogether or only allowing certain customers to purchase inventory on credit. The purpose of this strategy would be to only sell inventory on a cash basis or to only sell inventory on credit to those customers who have a good history of paying their outstanding balances within the credit terms offered.

The owner could also make a capital contribution of cash to the business. The inflow of cash will eliminate the cash shortage and improve the liquidity of the business by making it easier to pay their short-term debts as they fall due instead of relying on the bank overdraft facility. By having more cash available the business’ Accounts Payable Turnover could be faster and fall below the 26 days in 2015.

Justification _____

SAMPLE ANSWER B

The strategy that will provide the business with the most immediate benefit to overcoming a cash shortage would be to delay making payments to their suppliers. A suppliers provide credit terms of 30 days without any discounts for prompt payment, there is no incentive to pay them any earlier than the 30 days. By delaying payment until the due date, the business will have cash in the business for longer. However, the credit terms should not be exceeded as relationships can be damaged, credit facilities removed and cash being required to be used to source inventory which make any cash shortage issues worse.

Another strategy the business could implement to overcome cash shortages would be to alter their credit terms by increasing the discount offered. This could act as an incentive for credit customers to pay their outstanding accounts more promptly, improving the flow of cash into the business. However, if more accounts receivable balances are paid within the credit terms the business will see an increase in the Discount Expense which would reduce the Net Profit.

Another strategy the business could implement to overcome cash shortages would be to send out invoices more promptly and make contact with their credit customers as soon as payment is not received by the due date. By carefully monitoring any outstanding account balances, the business can send out reminders with the intent of collecting the cash faster. But the potential problem with this renewed approach to accounts receivable management is that additional staff may be required. These additional staff are required so as the business owner and key personnel can focus on generating revenue rather than fulfilling administrative duties. But this all comes at a cost, i.e., wages which need to be weighed up against the potential benefits.

Justification _____

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- strategies to interpret questions accurately
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UNIT 3: FINANCIAL ACCOUNTING FOR A TRADING BUSINESS

Area of

The preparation of financial reports at the end of the reporting period provides information to be used as a basis for planning and decision-making by the business owner. Students develop their understanding of the accounting processes and complete those processes that are applicable to the end of a reporting period for a trading business. They apply the accrual method of accounting to the preparation of accounting reports and draw a distinction between cash and profit, considering the implications of these differences when using reports to make decisions. Students undertake an analysis of accounting reports and interpret the information, taking into account relevant ethical considerations, in order to evaluate the performance of the business.

Outcome 2

On completion of this unit, the student should be able to record transactions and prepare, interpret and analyse accounting reports for a trading business.

To achieve this outcome, the student will draw on key knowledge and key skills outlined in Area of Study 2.

Key knowledge

- the accounting assumptions and qualitative characteristics
- documents used by a business to record financial transactions
- the recording of transactions using manual methods and ICT, including spreadsheets
- the process of balancing General Ledger accounts for assets, liabilities and owner's equity
- the recording of closing entries for revenue and expenses in the General Journal and in the General Ledger
- the preparation of the Profit and Loss Summary account in the General Ledger, with transfer of profit or loss to the Capital account in the General Journal and the General Ledger
- the recording of the transfer of drawings to the Capital account in the General Journal and General Ledger
- the characteristics and use of classified accounting reports:
 - Cash Flow Statement
 - Income Statement
 - Balance Sheet
- the effects of transactions on the accounting reports
- the distinction between cash and profit
- financial indicators and non-financial information used to measure business performance
- graphical representations related to preparing and interpreting accounting reports
- strategies to improve business performance
- ethical considerations in relation to recording and reporting of accounting information

Key skills

- use correct accounting terminology
- explain and apply relevant qualitative characteristics and accounting assumptions
- apply theoretical knowledge to simulated situations
- identify and record financial data manually in the General Journal and the General Ledger and manually prepare accounting reports
- use ICT, including spreadsheets, to record transactions in the General Journal and the General Ledger and prepare accounting reports
- construct appropriate graphical representations to assist with the analysis of classified accounting reports and other information to evaluate the performance of a business
- analyse the effects of financial transactions on the accounting reports
- distinguish between cash and profit
- discuss ethical considerations in relation to the recording and reporting of accounting information

One area of Unit 3 Outcome 1 was the recording of transactions that occurred during a reporting period for a trading business. This involved recording and posting to the General Ledger transactions involving the buying and selling of inventory as well as a variety of cash receipts and cash payments.

The focus of Unit 3 Outcome 2 is on the end of reporting period process required in the General Ledger and the reporting of summarised information for the purpose of evaluation, planning and decision-making culminating in the preparation of an Income Statement, Balance Sheet and Cash Flow Statement.

Christine's Canoes

Christine Williams owns and operates Christine's Canoes, a small business that prepares reports on a monthly basis.

Christine's Canoes for the month of May 2025 will be the business case study used for Unit 3 Area of Study 2.

BALANCING GENERAL LEDGER ACCOUNTS

Once the transactions for a reporting period are recorded in the General Journal and posted to the General Ledger, the amount (or balance) of each ledger account needs to be calculated and included in the Trial Balance.

Asset, Liability and Owner's Equity (Capital) accounts are required to be formally balanced.

Christine's Canoes' Bank ledger account for May 2025 appears below.

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/05	Balance	16 253	01/05	Rent / GST Clearing	2 750
03/05	Accounts Receivable	7 007	04/05	Drawings	2 000
08/05	Cash Sales / GST Clearing	2 871	06/05	Accounts Payable	10 241
11/05	Loan – MNC Bank	25 000	07/05	Office Equipment / GST Clearing	3 960
18/05	Cash Sales / GST Clearing	1 650	12/05	Advertising / GST Clearing	1 980
20/05	Capital	15 000	14/05	Wages	1 080
24/05	Accounts Receivable	13 200	15/05	Freight Inwards / GST Clearing	506
			18/05	Office Supplies / GST Clearing	638
			21/05	GST Clearing	874
			23/05	Van / GST Clearing	38 500
			24/05	Inventory / GST Clearing	4 180
			27/05	Drawings	2 000
			28/05	Wages	1 160
			29/05	Loan – MNC Bank	500
			30/05	Interest Expense	300
			31/05	Freight Outwards / GST Clearing	1 342

Step 1: Calculate which side of the ledger account has the largest total.

The debit side had a total of \$80 981 whilst the credit side had a total of \$72 011.

Step 2: Write the largest total from step 1 in each Amount column on the second last line.

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/05	Balance	16 253	01/05	Rent / GST Clearing	2 750
03/05	Accounts Receivable	7 007	04/05	Drawings	2 000
08/05	Cash Sales / GST Clearing	2 871	06/05	Accounts Payable	10 241
11/05	Loan – MNC Bank	25 000	07/05	Office Equipment / GST Clearing	3 960
18/05	Cash Sales / GST Clearing	1 650	12/05	Advertising / GST Clearing	1 980
20/05	Capital	15 000	14/05	Wages	1 080
24/05	Accounts Receivable	13 200	15/05	Freight Inwards / GST Clearing	506
			18/05	Office Supplies / GST Clearing	638
			21/05	GST Clearing	874
			23/05	Van / GST Clearing	38 500
			24/05	Inventory / GST Clearing	4 180
			27/05	Drawings	2 000
			28/05	Wages	1 160
			29/05	Loan – MNC Bank	500
			30/05	Interest Expense	300
			31/05	Freight Outwards / GST Clearing	1 342
		80 981			80 981

Step 3: In the Amount column on the side with the smallest total from step 1, write the amount in order to make both sides equal (\$80 981 - \$72 011 = \$8 970)

Bank (extract)

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			31/05	Freight Outwards / GST Clearing	1 342
					8 970
		80 981			80 981

Step 4: In the Date column on the same side as the amount from step 3, write the final date of the reporting period and label it 'Balance' in the cross-reference column.

Bank (extract)

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			31/05	Freight Outwards / GST Clearing	1 342
			31/05	Balance	8 970
		80 981			80 981

Step 5: On the last line of the ledger account on the opposite side of the ledger account entry in step 4, write the first date of the next reporting period in the Date column, write 'Balance' in the Cross-reference column and then write the same amount calculated in step 4.

Bank (extract)

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			31/05	Freight Outwards / GST Clearing	1 342
			31/05	Balance	8 970
		80 981			80 981
01/06	Balance	8 970			

Exam Tip: A General Ledger Account is not completely balanced unless the balance is carried forward to the start of the next reporting period. This includes dating the carried forward balance with the first date of the next reporting period.

As introduced in Outcome 1, once General Ledger accounts are either 'footed' or balanced, a Trial Balance can be prepared in order to ensure that the total debit entries equal the total credit entries. Explaining the purpose of a Trial Balance is a key skill of Outcome 1.

You might see in some resources a Trial Balance being referred to as a 'Pre-adjusted Trial Balance'. This terminology is only useful in the context of Unit 4.



Christine's Canoes

The Trial Balance for Christine's Canoes as at 31 May 2025 is presented below.

Christine's Canoes Trial Balance as at 31 May 2025

Account	Debit	Credit
Accounts Payable		10 200
Accounts Receivable	16 500	
Advertising	1 800	
Bank	8 970	
Capital		71 080
Cash Sales		4 110
Cost of Sales	7 830	
Credit Sales		21 180
Discount Expense	143	
Discount Revenue		209
Drawings	4 500	
Freight Inwards	460	
Freight Outwards	1 220	
GST Clearing		1 064
Interest Expense	300	
Inventory	28 000	
Inventory Loss	470	
Inventory Write Down	1 230	
Loan – MNC Bank		24 500
Office Equipment	7 500	
Office Supplies	580	
Rent Expense	2 500	
Sales Returns	1 800	
Shelving	11 300	
Van	35 000	
Wages	2 240	
Totals	132 343	132 343

Exam Tip: Just because the total debits equal the total credits in a Trial Balance does not necessarily mean that the Trial Balance is accurate. This may be due to a single transaction not being recorded, an amount may have been allocated to an incorrect General Ledger account or the debits and credits have been reversed.

END OF PERIOD PROCEDURES

At the end of each period the business is required to prepare financial reports and then prepare the General Ledger for the next period. This process involves closing revenue and expense accounts to the Profit and Loss Summary account, transferring the Profit or Loss and the Drawings to the Capital account and then balancing the Asset, Liability and Capital accounts.

Exam Tip: A common 1 mark exam question is to provide a reason why revenue and expense accounts are required to be closed at the end of the period. Revenue and expense accounts are required to be closed at the end of the period so as to calculate profit for the period and to prepare the General Ledger for the next period by returning their balances to zero. A more difficult concept for students is to link the closing of revenue and expense accounts with the support of qualitative characteristics and accounting assumptions.

The qualitative characteristic of relevance outlines that information is relevant with it is capable of making a difference to the decisions made by users. Further to this, the period assumption requires reports to be prepared for a particular period of time in order to obtain comparability of results. Probably the most important result to a business owner is the profit reported for each period. In order to determine profit for a period, the accrual basis assumption requires expenses incurred for a period to be subtracted from the revenue earned in that same period.

Closing entries ensure that only the revenues and expenses for a period are included in the calculation of profit. Without closing entries, it would be difficult and complex to determine the profit for any period once a Trial Balance is prepared. If the revenue and expense accounts are not reset to zero for the start of the following reporting period, the balances listed in the Trial Balance would reflect the totals from the start of the business, not from the start of the period.



The going concern assumption requires financial reports to be prepared on the assumption that the existing business will continue to operate into the future. The going concern assumption supports the reporting of assets and liabilities on a Balance Sheet. As assets represent future economic benefits, the asset accounts are not required to be closed at the end of the period but rather balanced. The balance amount is then carried forward to the next period as there is the expectation that these future economic benefits will be consumed in the future. Similarly, liabilities represent present obligations that are expected to be settled in the future. Alternatively, a simpler reason as to why asset and liability accounts are not required to be closed is that they are not involved in the calculation of profit.

CLOSING REVENUE ACCOUNTS

The VCE Study Design outlines that only one General Journal entry is required to close all revenues (including Sales Returns) to the Profit and Loss Summary account, resulting in only one entry in the General Ledger account.

Exam Tip: With the exception of Sales Returns, each of the revenue accounts required to be closed will be in the Credit column of a Trial Balance.

**Christine's Canoes
Trial Balance as at 31 May 2025**

Account	Debit	Credit
Accounts Payable		10 200
Accounts Receivable	16 500	
Advertising	1 800	
Bank	8 970	
Capital		71 080
Cash Sales		4 110
Cost of Sales	7 830	
Credit Sales		21 180
Discount Expense	143	
Discount Revenue		209
Drawings	4 500	
Freight Inwards	460	
Freight Outwards	1 220	
GST Clearing		1 064
Interest Expense	300	
Inventory	28 000	
Inventory Loss	470	
Inventory Write Down	1 230	
Loan – MNC Bank		24 500
Office Equipment	7 500	
Office Supplies	580	
Rent Expense	2 500	
Sales Returns	1 800	
Shelving	11 300	
Van	35 000	
Wages	2 240	
Totals	132 343	132 343



General Journal

Date	Details	Debit	Credit
31/05	Cash Sales	4 110	
	Credit Sales	21 180	
	Discount Revenue	209	
	Sales Returns		1 800
	Profit and Loss Summary		23 699

General Ledger (extract)

Cash Sales

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/05	Profit and Loss Summary	4 110	08/05	Bank	2 610
			18/05	Bank	1 500
		4 110			4 110

Credit Sales

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/05	Profit and Loss Summary	21 180	07/05	Accounts Receivable	12 000
			09/05	Accounts Receivable	3 300
			22/05	Accounts Receivable	5 880
		21 180			21 180

Discount Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/05	Profit and Loss Summary	209	06/05	Accounts Payable	209
		209			209

Sales Returns

Date	Cross-reference	Amount	Date	Cross-reference	Amount
26/05	Accounts Receivable	1 800	31/05	Profit and Loss Summary	1 800
		1 800			1 800

Profit and Loss Summary

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			31/05	Revenue Accounts	23 699

Christine's Canoes
Trial Balance as at 31 May 2025

Account	Debit	Credit
Accounts Payable		10 200
Accounts Receivable	16 500	
Advertising	1 800	
Bank	8 970	
Capital		71 080
Cash Sales		4 110
Cost of Sales	7 830	
Credit Sales		21 180
Discount Expense	143	
Discount Revenue		209
Drawings	4 500	
Freight Inwards	460	
Freight Outwards	1 220	
GST Clearing		1 064
Interest Expense	300	
Inventory	28 000	
Inventory Loss	470	
Inventory Write Down	1 230	
Loan – MNC Bank		24 500
Office Equipment	7 500	
Office Supplies	580	
Profit and Loss Summary (Revenue Accounts)		23 699
Rent Expense	2 500	
Sales Returns	1 800	
Shelving	11 300	
Van	35 000	
Wages	2 240	
Totals	130 543	130 543

CLOSING EXPENSE ACCOUNTS

The VCE Study Design outlines that only one General Journal entry is required to close all expenses to the Profit and Loss Summary account, resulting in only one entry in the General Ledger account.

Exam Tip: Each of the expense accounts required to be closed will be in the Debit column of a Trial Balance. If students were to 'cross out' the Asset amounts in the Debit column and the Drawings amount, the 'uncrossed out' amounts remaining in the Debit column will be the Expense accounts required to be closed.

Christine's Canoes Trial Balance as at 31 May 2025

Account	Debit	Credit
Accounts Payable		10 200
Accounts Receivable	16 500	
Advertising	1 800	
Bank	8 970	
Capital		71 080
Cash Sales		4 110
Cost of Sales	7 830	
Credit Sales		21 180
Discount Expense	143	
Discount Revenue		209
Drawings	4 500	
Freight Inwards	460	
Freight Outwards	1 220	
GST Clearing		1 064
Interest Expense	300	
Inventory	28 000	
Inventory Loss	470	
Inventory Write Down	1 230	
Loan – MNC Bank		24 500
Office Equipment	7 500	
Office Supplies	580	
Profit and Loss Summary (Revenue Accounts)		23 699
Rent Expense	2 500	
Sales Returns	1 800	
Shelving	11 300	
Van	35 000	
Wages	2 240	
Totals	130 543	130 543

General Journal

Date	Details	Debit	Credit
31/05	Profit and Loss Summary	18 773	
	Advertising		1 800
	Cost of Sales		7 830
	Discount Expense		143
	Freight Inwards		460
	Freight Outwards		1 220
	Interest Expense		300
	Inventory Loss		470
	Inventory Write Down		1 230
	Office Supplies		580
	Rent Expense		2 500
	Wages		2 240

General Ledger (extract)

Profit and Loss Summary

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/05	Expense Accounts	18 773	31/05	Revenue Accounts	23 699

Advertising

Date	Cross-reference	Amount	Date	Cross-reference	Amount
12/05	Bank	1 800	31/05	Profit and Loss Summary	1 800
		1 800			1 800

Cost of Sales

Date	Cross-reference	Amount	Date	Cross-reference	Amount
07/05	Inventory	4 000	26/05	Inventory	600
08/05	Inventory	870	31/05	Profit and Loss Summary	7 830
09/05	Inventory	1 100			
18/05	Inventory	500			
22/05	Inventory	1 960			
		8 430			8 430

Discount Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
03/05	Accounts Receivable	143	31/05	Profit and Loss Summary	143
		143			143

Freight Inwards

Date	Cross-reference	Amount	Date	Cross-reference	Amount
15/05	Bank	460	31/05	Profit and Loss Summary	460
		460			460

Freight Outwards

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/05	Bank	1 220	31/05	Profit and Loss Summary	1 220
		1 220			1 220

Interest Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/05	Bank	300	31/05	Profit and Loss Summary	300
		300			300

Inventory Loss

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/05	Inventory	470	31/05	Profit and Loss Summary	470
		470			470

Inventory Write Down

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/05	Inventory	1 230	31/05	Profit and Loss Summary	1 230
		1 230			1 230

Office Supplies

Date	Cross-reference	Amount	Date	Cross-reference	Amount
18/05	Bank	580	31/05	Profit and Loss Summary	580
		580			580

Rent Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/05	Bank	2 500	31/05	Profit and Loss Summary	2 500
		2 500			2 500

Wages

Date	Cross-reference	Amount	Date	Cross-reference	Amount
14/05	Bank	1 080	31/05	Profit and Loss Summary	2 240
28/05	Bank	1 160			
		2 240			2 240

Christine's Canoes

Trial Balance (extract) as at 31 May 2025

Account	Debit	Credit
Advertising	1 800	
Capital		71 080
Cash-Sales		4 110
Cost of Sales	7 830	
Credit Sales		21 180
Discount Expense	143	
Discount Revenue		209
Drawings	4 500	
Freight Inwards	460	
Freight Outwards	1 220	
GST Clearing		1 064
Interest Expense	300	
Inventory	28 000	
Inventory Loss	470	
Inventory Write-Down	1 230	
Loan – MNC Bank		24 500
Office Equipment	7 500	
Office Supplies	580	
Profit and Loss Summary (Revenue Less Expense Accounts)		4 926
Rent Expense	2 500	
Sales Returns	1 800	
Wages	2 240	

PROFIT AND LOSS SUMMARY ACCOUNT

The Profit and Loss Summary account is a temporary account in nature. At the end of each period, the balances of revenue and expense accounts are transferred to the Profit and Loss Summary account in order to calculate the Profit or Loss for the period. Just like the Revenue and Expense accounts, the Profit and Loss Summary account also needs to be closed at the end of the reporting period.

However, the amount needed to 'balance' the Profit and Loss Summary account represents either the Net Profit or Net Loss, which needs to be transferred to the Capital account at the end of the reporting period.

Christine's Canoes

Trial Balance (extract) as at 31 May 2025

Account	Debit	Credit
Capital		71 080
Drawings	4 500	
Profit and Loss Summary		4 926

Profit and Loss Summary

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/05	Expense Accounts	18 773	31/05	Revenue Accounts	23 699
		4 926			

General Journal

Date	Details	Debit	Credit
31/05	Profit and Loss Summary	4 926	
	Capital		4 926

Profit and Loss Summary

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/05	Expense Accounts	18 773	31/05	Revenue Accounts	23 699
31/05	Capital	4 926			
		23 699			23 699

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/05	Balance	71 080
			31/05	Capital	4 926
					76 006

TRANSFER OF DRAWINGS TO THE CAPITAL ACCOUNT

When revenue and expense accounts are not reset to zero for the start of the following period, the balances listed in the Trial Balance would reflect the totals from the start of the business, not from the start of the reporting period.

The same issue also applies to the balance of the Drawings account. It is important for the users of reports to identify the amount of Drawings for the period, not the total of Drawings since the start of the business. Therefore, the balance of the Drawings account needs to be transferred to the Capital account at the end of the period.

Christine's Canoes

Trial Balance (extract) as at 31 May 2025

Account	Debit	Credit
Capital		76 006
Drawings	4 500	

Drawings

Date	Cross-reference	Amount	Date	Cross-reference	Amount
04/05	Bank	2 000			
22/05	Inventory	500			
27/05	Bank	2 000			
		4 500			

General Journal

Date	Details	Debit	Credit
31/05	Capital		4 500
	Drawings	4 500	

Drawings

Date	Cross-reference	Amount	Date	Cross-reference	Amount
04/05	Bank	2 000	31/05	Capital	4 500
22/05	Inventory	500			
27/05	Bank	2 000			
		4 500			4 500

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/05	Drawings	4 500	01/05	Balance	71 080
			31/05	Capital	4 926
					71 506

**Christine's Canoes
Trial Balance
as at 31 May 2025**

Account	Debit	Credit
Accounts Payable		10 200
Accounts Receivable	16 500	
Advertising	1 800	
Bank	8 970	
Capital		71 506
Cash Sales		4 110
Cost of Sales	7 830	
Credit Sales		21 180
Discount Expense	143	
Discount Revenue		209
Drawings	4 500	
Freight Inwards	460	
Freight Outwards	1 220	
GST Clearing		1 064
Interest Expense	300	
Inventory	28 000	
Inventory Loss	470	
Inventory Write-Down	1 230	
Loan – MNC Bank		24 500
Office Equipment	7 500	
Office Supplies	580	
Profit and Loss Summary (Revenue Less Expense Accounts)		4 926
Rent Expense	2 500	
Sales Returns	1 800	
Shelving	11 300	
Van	35 000	
Wages	2 240	
Totals	107 270	107 270

INCOME STATEMENT

The Income Statement reports the revenues earned and the expenses incurred by the business for the period.

Christine's Canoes Income Statement for the month ending 31 May 2025

	\$	\$
Revenues		
Cash Sales	4 110	
Credit Sales	21 180	
Less: Sales Returns	1 800	23 490
Less: Cost of Goods Sold		
Cost of Sales	7 830	
Freight Inwards	460	8 290
Gross Profit		15 200
Less: Inventory Loss	470	
Less: Inventory Write Down	1 230	1 700
Adjusted Gross Profit		13 500
Plus: Other Revenues		
Discount Revenue		209
		13 709
Less: Other Expenses		
Advertising	1 800	
Discount Expense	143	
Freight Outwards	1 220	
Interest Expense	300	
Office Supplies	580	
Rent Expense	2 500	
Wages Expense	2 240	8 783
Net Profit / (Loss)		4 926

Sales Returns are reported separately so as to assess the quality and suitability of the inventory sold.

The items reported under the heading Cost of Goods Sold are all the costs incurred in getting the inventory into a condition and location ready for sale. Students can expect to report Cost of Sales plus an additional expense such as Cartage Inwards, Customs Duties, Freight Inwards or Import Duties.

The Gross Profit reports the profit the business has made from simply buying and selling their inventory.

The purpose of reporting an Adjusted Gross Profit is that the business' management of their inventory can be assessed. The Gross Profit is adjusted by any Inventory Losses or Write Downs. This would enable the business to monitor the effectiveness of their security to reduce theft and the monitoring of their inventory levels to minimise wastage.

Students must include a sub-total below Other Revenue.

The result reported in the Income Statement must be labelled.

APPLICATION EXERCISE 10

Steph's Shoes

Steph Ora owns and operates Steph's Shoes, a small business that prepares reports on a monthly basis.

The Trial Balance for Steph's Shoes as at 30 June 2025 is presented below.

Steph's Shoes

Trial Balance as at 30 June

Account	Debit	Credit
Accounts Payable		3 960
Accounts Receivable	4 796	
Advertising	1 380	
Bank		2 120
Capital		44 264
Cartage Inwards	920	
Cartage Outwards	330	
Cash Sales		6 940
Cost of Sales	4 625	
Credit Sales		1 790
Discount Expense	176	
Discount Revenue		121
Drawings	1 940	
Equipment	13 990	
GST Clearing		432
Import Duties	210	
Interest Expense	135	
Inventory	27 400	
Inventory Loss	560	
Inventory Write Down	1 020	
Loan – MNC Bank		18 000
Rent Expense	1 800	
Sales Returns	405	
Shelving	15 400	
Wages	2 540	
Totals	77 627	77 627

Additional information

- On 6 June 2025 Steph withdrew \$1 300 for personal use.
- On 19 June 2025 Steph made a \$8 000 capital contribution.
- On 27 June 2025 Steph withdrew shoes with a cost price of \$640 for personal use.

- a. Prepare the General Journal entries required on 30 June 2025 to close the revenue and expense accounts.
Narrations are not
- b. Show how the following accounts would appear in the General Ledger of Steph's Shoes after all closing and transferring entries have been posted.
- *Profit and Loss Summary*
 - *Drawings*
 - *Capital*

You are

Prepare the Income Statement for Steph's Shoes for the month ending 30 June 2025.

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Analysis of Business Performance

As was introduced in Outcome 1 of Unit 3, there are other ways to assess the performance of a business than just looking at the profit or loss reported in the Income Statement or the increase or decrease in cash as per the Cash Flow Statement.

A reminder that the VCE Accounting Study Design provides twelve financial indicators students can use to measure business performance in relation to profitability, liquidity and stability.

Profitability compares the profit the business makes to a base figure such as sales, capital or assets and is generally expressed as a percentage.

Liquidity measures the ability of a business to meet its short-term debts as they fall due.

Stability measures the ability of a business to meet its debts and continue its operations in the long term.

Also, the analysis of a business' performance generally involves comparing the result of the current period to one of four **benchmarks**:

1. Previous period
2. Budget
3. Industry average
4. Alternative investments

In this section of Outcome 2 the profitability indicators are introduced.

Exam Tip: Students are not required to calculate any of the 12 indicators. However, in order to explain why an indicator has changed or how to improve the indicator, students need to know how the indicators are calculated. For example, if the top number increases by a greater percentage than the percentage increase in the bottom number, the indicator has improved. Alternatively, if the bottom number increases by a greater percentage than the percentage increase in the top number, the indicator has worsened.

ASSET TURNOVER

The Asset Turnover measures how effectively the business' assets have been to generate sales.

The Asset Turnover formula is as follows:

$$\frac{\text{Net Sales}}{\text{Average Total Assets}}$$

The Asset Turnover is expressed as 'times per period' with changes being described as faster or slower.

Strategies to Improve the Asset Turnover

- Increase Sales
- Sell idle Non-Current Assets

Exam Tip: When the Asset Turnover is multiplied by the Net Profit Margin the Return on Assets indicator is determined.

GROSS PROFIT MARGIN

The Gross Profit Margin measures how much profit is retained by the business from buying and selling inventory.

The Gross Profit Margin formula is as follows:

$$\frac{\text{Gross Profit}}{\text{Net Sales}} \times \frac{100}{1}$$

The Gross Profit Margin is expressed as percentage with changes being described as an increase or a decrease.

Strategies to Improve the Gross Profit Margin

- Increase selling prices whilst keeping cost prices constant
- Reduce cost prices whilst keeping selling prices constant

Exam Tip: Students need to be mindful that there is a difference between the Gross Profit and the Gross Profit Margin. The Gross Profit is a dollar amount where the Cost of Goods Sold are deducted from the Net Sales. Whereas, the Gross Profit Margin is the Gross Profit expressed as a percentage of Net Sales. A business can therefore see a decrease in the Gross Profit Margin yet see an increase in the Gross Profit. A business can reduce their Gross Profit Margin by reducing their selling prices yet see an increase in the volume of units sold resulting in an increase in the Gross Profit.

NET PROFIT MARGIN

The Net Profit Margin measures the amount of profit retained by the business from each dollar of sales.

The Net Profit Margin formula is as follows:

$$\frac{\text{Net Profit}}{\text{Net Sales}} \times \frac{100}{1}$$

The Net Profit Margin is expressed as percentage with changes being described as an increase or a decrease.

Strategies to Improve the Net Profit Margin

- Increase Other Revenue
- Improve Expense Control

Exam Tip: Expense control is the concept most closely linked to the Net Profit Margin. If the Net Profit Margin has improved, the business has demonstrated improved expense control. This means that the Profit has increased by a greater percentage than the percentage increase in Sales. Alternatively, if the Net Profit Margin has worsened, the business has demonstrated worse expense control. This means that the Sales have increased by a greater percentage than the percentage increase in Profit.

Exam Tip: If the Sales amount and the Net Profit Margin are provided, students should multiply them together to calculate an approximate Net Profit. This can provide students with data to enable them to demonstrate an understanding of the difference between the concepts of profit and profitability. A common scenario is for the Net Profit Margin to decline yet the actual Net Profit increase. The owner would be happy to see an increase in the Net Profit, yet the accountant will know that this may not necessarily be a favourable outcome.

RETURN ON ASSETS

The Return on Assets measures the amount of profit earned by the business from each dollar of assets.

The Return on Assets' formula is as follows:

$$\frac{\text{Net Profit}}{\text{Average Total Assets}} \times \frac{100}{1}$$

The Return on Assets is expressed as percentage with changes being described as an increase or decrease.

Strategies to Improve the Return on Assets

- Increase the Net Profit
- Sell idle Non-Current Assets

RETURN ON OWNER'S INVESTMENT

The Return on Owner's Investment measures the amount of profit earned by the business from each dollar of capital.

The Return on Owner's Investment formula is as follows:

$$\frac{\text{Net Profit}}{\text{Average Capital}} \times \frac{100}{1}$$

The Return on Owner's Investment is expressed as percentage with changes being described as an increase or decrease.

Strategies to Improve the Management of Accounts Payable

- Increase the Net Profit
- Increase Drawings to reduce Capital
- Increase the Debt Ratio (covered in the next section)

Exam Tip: Students are often presented in exams with a number of indicators and asked to 'discuss' the performance of the business. As a minimum, students should explain whether each of the indicators has improved or worsened. A more in-depth response would include an explanation of the difference between the concept of profit and profitability and further analysis of the relationships between the indicators presented.

NON-FINANCIAL INDICATORS

There are other ways to assess the performance of a business other than the profit and profitability indicators.

Non-financial indicators are a way an owner can assess the performance of the business and include:

- number of Sales Returns
- number of repeat customers
- results of customer surveys
- level of Staff Turnover
- results of employee surveys
- number of visits to the business website

APPLICATION EXERCISE 1

Watson's Windows

Saje Watson owns and operates Watson's Windows, a small business that prepares reports on an annual basis. Saje's accountant has provided the following information. Discuss

Indicator	2024	2025
Total Sales	\$600 000	\$900 000
Gross Profit Margin	55%	45%
Net Profit Margin	8%	7%
Average Assets	\$400 000	\$500 000

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BALANCE SHEET

A Balance Sheet reports the business' assets, liabilities and owner's equity and is a representation of the accounting equation.

Christine's Canoes

Trial Balance as at 31 May 2025

Account	Debit	Credit
Accounts Payable		10 200
Accounts Receivable	16 500	
Advertising	1 800	
Bank	8 970	
Capital		71 506
Cash Sales		4 110
Cost of Sales	7 830	
Credit Sales		21 180
Discount Expense	143	
Discount Revenue		209
Drawings	4 500	
Freight Inwards	460	
Freight Outwards	1 220	
GST Clearing		1 064
Interest Expense	300	
Inventory	28 000	
Inventory Loss	470	
Inventory Write-Down	1 230	
Loan – MNC Bank		24 500
Office Equipment	7 500	

Office Supplies	580	
Profit and Loss Summary (Revenue Less Expense Accounts)		4 926
Rent Expense	2 500	
Sales Returns	1 800	
Shelving	11 300	
Van	35 000	
Wages	2 240	
Totals	107 270	107 270

**Christine's Canoes
Balance Sheet as at 31 May 2025**

	\$	\$		\$	\$
Current Assets			Current Liabilities		
Bank	8 970		Accounts Payable	10 200	
Accounts Receivable	16 500		GST Clearing	1 064	
Inventory	28 000	53 470	Loan – MNC Bank	6 000	17 264
Non-Current Assets			Non-Current Liabilities		
Office Equipment	7 500		Loan – MNC Bank		18 500
Shelving	11 300		Owner's Equity		
Van	35 000	53 800	Capital	71 080	
			Plus: Profit	4 926	
			Less: Drawings	4 500	71 506
Total Assets		107 270	Total Equities		107 270

There are many aspects of a Balance Sheet that students need to be aware of.

The first would be the term 'classification'. Classification refers to whether an item is reported under the heading Current Assets, Non-Current Assets, Current Liabilities, Non-Current Liabilities or Owner's Equity. Therefore, students need to be familiar with their definitions.

A loan balance is often required to be classified between a Current Liability and a Non-Current Liability. The key to this skill is to first realise that a Balance Sheet needs to report the total amount owing to a bank. The total amount owing is then split between the amount expected to be repaid within the next 12 months (Current Liability) and the remaining amount owing (Non-Current Liability). Students need to identify the words 'monthly', 'quarterly', 'half-yearly' or 'annually' in the question.

Two accounts that warrant careful consideration are Bank and GST Clearing. It would be tempting for students to always classify these two accounts under their 'usual' heading. However, the balances of Bank and GST Clearing can be classified under the Current Assets and Current Liabilities headings.

Following on from the term 'classification' is the term 'extract'. An extract is a section of a report such as the Current Assets or Current Liabilities. The 'Equities' section refers to both the Liabilities and Owner's Equity section of the Balance Sheet.

Another use of a Balance Sheet is that the values reported can be used in the calculation of financial indicators such as Return on Assets, Return on Owner's Investment and Asset Turnover.

A Balance Sheet can also be used to assess the liquidity of a business through the calculation of the Working Capital Ratio and Quick Asset Ratio. The stability of a business can also be assessed through the calculation of the Debt Ratio. These topics will be introduced in the next section of Unit 3 Outcome 2.

APPLICATION EXERCISE 1

Steph's Shoes

Steph Ora owns and operates Steph's Shoes, a small business that prepares reports on a monthly basis. The Trial Balance for Steph's Shoes as at 30 June 2025 is presented below.

Steph's Shoes

Trial Balance as at 30 June

<i>Account</i>	<i>Debit</i>	<i>Credit</i>
<i>Accounts Payable</i>		<i>3 960</i>
<i>Accounts Receivable</i>	<i>4 796</i>	
<i>Advertising</i>	<i>1 380</i>	
<i>Bank</i>		<i>2 120</i>
<i>Capital</i>		<i>44 264</i>
<i>Cartage Inwards</i>	<i>920</i>	
<i>Cartage Outwards</i>	<i>330</i>	
<i>Cash Sales</i>		<i>6 940</i>
<i>Cost of Sales</i>	<i>4 625</i>	
<i>Credit Sales</i>		<i>1 790</i>
<i>Discount Expense</i>	<i>176</i>	
<i>Discount Revenue</i>		<i>121</i>
<i>Drawings</i>	<i>1 940</i>	
<i>Equipment</i>	<i>13 990</i>	
<i>GST Clearing</i>		<i>432</i>
<i>Import Duties</i>	<i>210</i>	
<i>Interest Expense</i>	<i>135</i>	
<i>Inventory</i>	<i>27 400</i>	
<i>Inventory Loss</i>	<i>560</i>	
<i>Inventory Write Down</i>	<i>1 020</i>	
<i>Loan – MNC Bank</i>		<i>18 000</i>
<i>Rent Expense</i>	<i>1 800</i>	
<i>Sales Returns</i>	<i>405</i>	
<i>Shelving</i>	<i>15 400</i>	
<i>Wages</i>	<i>2 540</i>	
<i>Totals</i>	<i>77 627</i>	<i>77 627</i>

Additional information

- Loan repayments of \$250 are made to MNC Bank on a monthly basis.
- Income Statement reported a Net Loss of \$5 250 for the month ended 30 June 2025

Prepare a fully classified Balance Sheet for Steph's Shoes as at 30 June 2025.

Download templates to complete all Application Exercises at <https://www.commpap.com/page90-2/>

DEBT RATIO

The Debt Ratio is a stability indicator that measures the extent to which a business' assets are financed by external debt.

The Debt Ratio formula is as follows:

$$\frac{\text{Total Liabilities}}{\text{Total Assets}} \times \frac{100}{1}$$

The Debt Ratio is expressed as percentage with changes being described as an increase or a decrease.

Exam Tip: There is a relationship between the Debt Ratio and the Return on Owner's Investment indicator. When students see an increase in the Debt Ratio the first thing they should state that the business has a greater reliance on external debt and less reliance on the owner's funds. If the profit then remains relatively the same, the Return on Owner's Investment indicator would increase, as profit, expressed as a percentage of capital, would increase.

Strategies to Improve the Debt Ratio

- Reduce Liabilities
- Made a Capital Contribution

WORKING CAPITAL RATIO

The Working Capital Ratio is a liquidity measure that compares a business's Current Assets to their Current Liabilities.

The Working Capital Ratio formula is as follows:

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

The Working Capital Ratio is expressed as a ratio of Current Assets to Current Liabilities with changes being described as an increase or a decrease.

Strategies to Improve the Working Capital Ratio

- Take out a long-term loan
- Make a Capital contribution of cash

Exam Tip: As a general rule, the higher the Working Capital Ratio the better for the liquidity of the business. As a business would have more Current Assets available to pay their Current Liabilities, the business would be in a better position to meet their short-term debts as they fall due. However, when a business has significantly more Current Assets compared to their Current Liabilities, it can potentially have a negative effect on the profitability of a business. A contributing factor to a business having a significant balance of Current Assets could be due to Inventory. If a business has a large balance of Inventory, there is a greater likelihood of an Inventory Write Down being recorded. Similarly, a large balance of Accounts Receivable could see a greater likelihood of Bad Debts being recorded.

Exam Tip: A limitation of using the Working Capital Ratio to assess the liquidity of a business is that it doesn't assess the speed of the liquidity as the composition of the Current Assets can be unknown. A business could have a large percentage of their Current Assets made up by Inventory yet have Accounts Payable balances and loan repayments to be made.

QUICK ASSET RATIO

The Quick Asset Ratio is a liquidity indicator which attempts to overcome the limitation of the Working Capital Ratio by comparing a business' immediate cash assets with their Current Liabilities.

The Quick Asset Ratio formula is as follows:

$$\frac{\text{Current Assets} - (\text{Inventory} + \text{Prepayments})}{\text{Current Liabilities}}$$

The Quick Asset Ratio is expressed as a ratio of quick assets to Current Liabilities with changes being described as an increase or a decrease.

Strategies to Improve the Quick Asset Ratio

- Take out a long-term loan
- Make a capital contribution of cash



CASH FLOW COVER

The Cash Flow Cover is a liquidity indicator which measures the ability of the business to generate sufficient cash from their day-to-day trading activities to pay their Current Liabilities.

The Cash Flow Cover formula is as follows:

$$\frac{\text{Net Cash Flow From Operating Activities}}{\text{Average Current Liabilities}}$$

The Cash Flow Cover is expressed as 'times per period' with changes being described as faster or slower.

Strategies to Improve the Cash Flow Cover

- Take out a long-term loan
- Make a capital contribution of cash
- Improve the Accounts Receivable Turnover

CASH FLOW STATEMENT

The Cash Flow Statement reports a summary of a business' cash transactions for a period of time.

It is an important report as it can be used to assess the ability of the business to generate cash and its uses of cash.

A Cash Flow Statement classifies the cash inflows and cash outflows for the period into three categories.

1. Cash Flows from Operating Activities

Operating activities refers to cash flows relating to the day-to-day trading activities of the business such as the buying and selling of inventory.

Importance of Cash Flows from Operating Activities

It is important for a business' long-term survival that they are able to generate positive cash flows from operating activities. A business will be able to expand by purchasing additional non-current assets, increase Advertising, meet existing loan repayments or provide the owner with cash Drawings **without** relying on a cash capital contribution or additional loan borrowings.

Alternatively, if a business is unable to consistently generate positive cash flows from operating activities, they will **not** be able to expand by buying additional non-current assets, increase Advertising, meet existing loan repayments or provide the owner with cash Drawings without relying on a cash capital contribution or additional loan borrowings.

2. Cash Flows from Investing Activities

Investing activities refers to cash flows relating to the purchase and disposal of non-current assets such as the purchase of the Office Equipment.

3. Cash Flows from Financing Activities

Financing activities refers to cash flows relating to changes in the financial structure of the business such as Capital, Loans and Drawings.

Exam Tip: Students need to be able to define each of the three Cash Flow Statements categories. A common examination question is to ask students to explain what is meant by the term '**Net**' Cash Flows from Operating, Investing or Financing Activities. The key to this explanation is to start the response with 'Cash inflows less cash outflows relating to' and provide an example from the category in the question.

The following table outlines the items that are included in each of the categories of a Cash Flow Statement.

Category	Financing	Investing	Operating
Items	Capital Loan Borrowings – Name of Bank Drawings Loan Repayments – Name of Bank	Disposal of Name of Asset Purchase of Name of Asset	Everything else!

Christine's Canoes' Cash at Bank General Ledger account for May 2025 appears below.

Bank					
Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/05	Balance	16 253	01/05	Rent / GST Clearing	2 750
03/05	Accounts Receivable	7 007	04/05	Drawings	2 000
08/05	Cash Sales / GST Clearing	2 871	06/05	Accounts Payable	10 241
11/05	Loan – MNC Bank	25 000	07/05	Office Equipment / GST Clearing	3 960
18/05	Cash Sales / GST Clearing	1 650	12/05	Advertising / GST Clearing	1 980
20/05	Capital	15 000	14/05	Wages	1 080
24/05	Accounts Receivable	13 200	15/05	Freight Inwards / GST Clearing	506

			18/05	Office Supplies / GST Clearing	638
			21/05	GST Clearing	874
			23/05	Van / GST Clearing	38 500
			24/05	Inventory / GST Clearing	4 180
			27/05	Drawings	2 000
			28/05	Wages	1 160
			29/05	Loan – MNC Bank	500
			30/05	Interest Expense	300
			31/05	Freight Outwards / GST Clearing	1 342

Exam Tip: Cash inflows are to be reported first with cash outflow amounts reported in brackets next. The description of entries in the Cash Flow Statement are designed to be descriptive in nature rather than writing the cross references as they appear in the Bank General Ledger. For example, Receipts from Accounts Receivable is used rather than just Accounts Receivable. Other examples include Purchase of Van instead of just Van, Loan borrowings and repayments instead of just loan.

Alternatively, the information contained in the Bank General Ledger account could be summarised as follows.

Summary of Receipts	\$	Summary of Payments	\$
Capital	15 000	Advertising	1 800
Cash Sales	4 110	Drawings	4 000
GST Collected	411	Freight Inwards	460
Loan Borrowings – MNC Bank	25 000	Freight Outwards	1 220
Receipts from Accounts Receivable	20 207	GST Paid	4 896
		GST Settlement	874
		Interest Paid	300
		Loan Repayments – MNC Bank	500
		Office Equipment	3 600
		Office Supplies	580
		Payments to Accounts Payable	10 241
		Purchases of Inventory	3 800
		Purchase of Van	35 000
		Rent	2 500
		Wages	2 240
	64 728		72 011

Christine's Canoes
Cash Flow Statement for the month ending 31 May 2025

	\$	\$
Cash Flows from Operating Activities		
Cash Sales	4 110	
GST Collected	411	
Receipts from Accounts Receivable	20 207	
Payments to Accounts Payable	(10 241)	
Purchase of Inventory	(3 800)	
Rent	(2 500)	
Advertising	(1 800)	
Wages	(2 240)	
Freight Inwards	(460)	
Office Supplies	(580)	
GST Settlement	(874)	
Interest Paid	(300)	
Freight Outwards	(1 220)	
GST Paid	(4 896)	
Net Cash Flows from Operations		(4 183)
Cash Flows from Investing Activities		
Purchase of Office Equipment	(3 600)	
Purchase of Van	(35 000)	
Net Cash Flows from Investing Activities		(38 600)
Cash Flows from Financing Activities		
Capital	15 000	
Loan Borrowings – MNC Bank	25 000	
Drawings	(4 000)	
Loan Repayments – MNC Bank	(500)	
Net Cash Flows from Financing Activities		35 500
Net Increase / (Decrease) in Cash Position		(7 283)
Bank Balance at 1 May 2025		16 253
Bank Balance at 31 May 2025		8 970

Exam Tip: The very first item a student should complete in the Cash Flow Statement is the Net Increase / (Decrease) in Cash Position amount. This amount will be equal to the total Cash Receipts less total Cash Payments. This amount provides students with a 'cross-checking' mechanism whereby once all the receipts and payments have been recorded in the Cash Flow Statement, the Net Increase / (Decrease) in Cash Position can again be calculated and checked against the initial calculation. If the amounts are different, either a recording error or a calculation error has occurred.

APPLICATION EXERCISE

Steph's Shoes

Steph Ora owns and operates Steph's Shoes, a small business that prepares reports on a monthly basis.

Steph's Shoes' Bank General Ledger account for June 2025 appears below.

Bank

Date	Cross	Amount	Date	Cross	Amount
01/06	Balance	4 987	01/06	Rent / GST Clearing	1 980
02/06	Accounts Receivable	5 929	03/06	Accounts Payable	8 624
07/06	Cash Sales / GST Clearing	3 256	04/06	Advertising / GST Clearing	1 518
10/06	Loan – MNC Bank	5 000	06/06	Drawings	1 300
18/06	Cash Sales / GST Clearing	1 584	08/06	Import Duties / GST Clearing	231
19/06	Capital	8 000	11/06	Inventory / GST Clearing	4 400
29/06	Cash Sales / GST Clearing	2 794	12/06	Cartage Inwards / GST Clearing	1 012
30/06	Balance	2 120	14/06	Wages	1 270
			18/06	Shelving / GST Clearing	4 510
			19/06	Cartage Outwards / GST Clearing	363
			20/06	Loan – MNC Bank	250
			20/06	Interest	135
			21/06	GST Clearing	1 307
			28/06	Wages	1 270
			29/06	Accounts Payable	5 500
		33 670			33 670
			01/07	Balance	2 120

Prepare the Cash Flow Statement for Steph's Shoes for the month ending 30 June 2025.

Download templates to complete all Application Exercises at <https://www.commpap.com/page90-2/>

MINI EXAM NO 2: UNIT 3 AREA OF STUDY 2 (50 MARKS)**Question 1** (24 marks)

Arthur Daly owns and operates Arthur's Air Conditioners, a small business that prepares reports on a monthly basis. The Trial Balance for Arthur's Air Conditioners as at 31 March 2025 is presented below.

**Arthur's Air Conditioners
Trial Balance as at 31 March 2025**

Account	Debit	Credit
Accounts Payable		7 040
Accounts Receivable	14 630	
Advertising	1 500	
Bank		10 670
Capital		75 197
Cash Sales		7 420
Cost of Sales	6 790	
Credit Sales		14 040
Customs Duties	830	
Discount Expense	121	
Discount Revenue		143
Drawings	4 500	
Freight Inwards	720	
Freight Outwards	190	
GST Clearing		1 116
Interest Expense	125	
Inventory	30 000	
Inventory Loss	560	
Inventory Write Down	2 010	
Loan – MNC Bank		18 000
Office Equipment	8 060	
Rent Expense	3 000	
Sales Returns	1 090	
Shelving	12 500	
Van	42 890	
Wages	4 110	
Totals	133 626	133 626

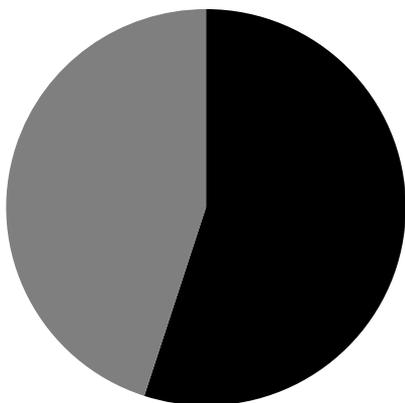
Additional information

- On 16 March 2025 Arthur made a \$15 000 capital contribution.
 - Loan repayments of \$1 200 are made quarterly to MNC Bank.
- a. Prepare the General Journal entry to close the revenue accounts on 31 March 2025.
A narration is **not** required. 3 marks
- b. Explain how recording closing entries satisfies the qualitative characteristic of relevance. 2 marks
- c. Prepare the Income Statement for the month ended 31 March 2025. 8 marks
- d. Explain the purpose of reporting the Adjusted Gross Profit in an Income Statement. 2 marks
- e. Show how the Profit and Loss Summary and Capital accounts would appear in the General Ledger after all closing and transfer entries have been made on 31 March 2025.
You **are** required to balance the Capital account. 6 marks
- f. Prepare the Equities section of the Balance Sheet as at 31 March 2025. 3 marks

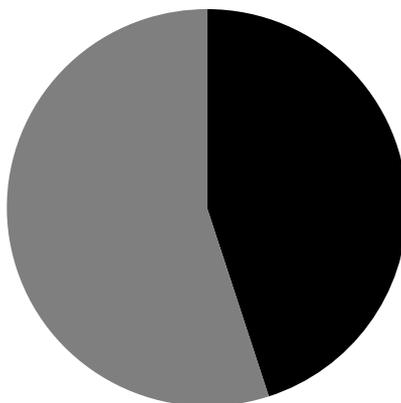
Question 2 (4 marks)

Makayla Pence owns and operates Makayla's Merchandise, a small business that sells sporting clothes. Makayla's accountant has provided the following information for you to explain to Makayla.

% of Sales (2024)



% of Sales (2025)



■ Cost of Goods Sold
■ Gross Profit

- a. Explain whether Makayla's Merchandise's mark-up percentage has increased or decreased from 2024 to 2025. 2 marks
- b. Explain how an increase in the mark-up could actually lead to a decrease in Gross Profit. 2 marks

Question 3 (11 marks)

Rita Panahi owns and operates Panahi's Paint, a small business that prepares reports on a monthly basis.

As at 1 April 2025 Panahi's Paint had a bank overdraft balance of \$3 140.

The information contained in the Bank General Ledger account for April 2025 has been summarised as follows.

Summary of Receipts	\$	Summary of Payments	\$
Capital	30 000	Advertising	1 280
Cash Sales	11 780	Drawings	2 900
GST Collected	1 178	Freight Inwards	1 060
Loan Borrowings – MNC Bank	12 000	Freight Outwards	340
Receipts from Accounts Receivable	3 300	GST Paid	4 507
		GST Settlement	774
		Interest Paid	125
		Loan Repayments – MNC Bank	250
		Payments to Accounts Payable	6 600
		Purchases of Inventory	8 400
		Purchase of Shelving	3 800
		Purchase of Van	27 990
		Rent	2 200
		Wages	1 900
	58 258		62 126

a. Prepare the Cash Flow Statement for the month ending 30 April 2025.

8 marks

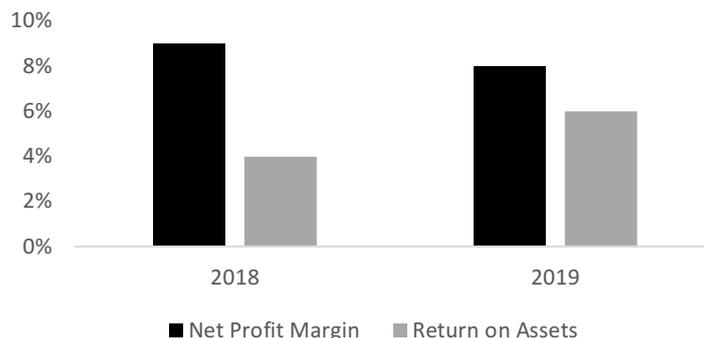
b. Explain to Rita, with the use of an example, how the Cash Flow Statement reported a Net Decrease in Cash but the Income Statement reported a Net Profit for the month ending 30 April 2025.

3 marks

Question 4 (3 marks)

Bernard Sanders owns and operates Bernard’s Books.

Bernard’s accountant has provided the following information for you to explain to Bernard.



- a. Explain how it is possible for the Return on Assets to improve even though the Net Profit Margin declined. 2 marks
- b. State one non-financial indicator Bernard could use to assess the performance of his business. 1 mark

Question 5 (5 marks)

Kevin Nguyen owns and operates Kevin’s Kettles, a small business that prepares reports on an annual basis.

Kevin’s accountant has provided the following information for you to explain to Kevin.

Indicator	2024	2025
Working Capital Ratio	1.25 : 1	3.95 : 1
Quick Asset Capital Ratio	1.15 : 1	1.05 : 1

- a. With the use of an example, explain how it is possible that the Working Capital Ratio trend is favourable while the Quick Asset Ratio trend is unfavourable. 2 marks
- b. Explain one possible negative effect on the profitability of Kevin’s Kettles as a result of the trend in the Working Capital Ratio. 2 marks
- c. State **one** limitation of using the Working Capital Ratio as an indicator of business liquidity. 1 mark

Question 6 (3 marks)

Marcia Rubio owns and operates Rubio’s Retail, a small business that prepares reports on an annual basis.

Marcia’s accountant has provided the following information for you to explain the Marcia.

Indicator	2024	2025
Debt Ratio	40%	75%
Cash Flow Cover	14 times	10 times

Explain the implication of the change in the Debt Ratio on the Cash Flow Cover.

END OF MINI EXAM NO. 2

YOU BE THE ASSESSOR: UNIT 3 AREA OF STUDY 2

In this section, you are required to assess the responses presented for each of the questions. You should award the responses a score and justify your decision. Once complete, compare your assessment to that of the author provided at the CPAP website <http://www.commpap.com/page90.html>

Question 1 (2018 VCAA June Exam Question 5 modified)

JBSport sells sporting goods to clubs and to the public. It prepares reports at the end of each month.

Relevant account balances from JBSport's adjusted Trial Balance at 31 July 2018 were:

	\$
Advertising	4 000
Sales	285 000
Cost of Sales	109 000
Wages	68 000
Rent	13 000
Discount Revenue	2 000
Capital	350 000
Drawings	38 000

Using the information provided, prepare the General Journal entry to close expense accounts.

Narrations are not required.

3 marks

SAMPLE ANSWER A

General Journal

Date	Details	Debit	Credit
31/07	Profit and Loss Summary		194 000
	Advertising	4 000	
	Cost of Sales	109 000	
	Rent Expense	13 000	
	Wages	68 000	

Justification _____

SAMPLE ANSWER B

General Journal

Date	Details	Debit	Credit
31/07	Profit and Loss Summary	194 000	
	Advertising		4 000
	Cost of Sales		109 000
	Rent Expense		13 000
	Wages		68 000

Justification _____

Show how the Profit and Loss Summary account and the Capital account would appear in the General Ledger after the closing entries were posted. No additional capital was contributed during the period.

You are not required to balance the accounts.

6 marks

SAMPLE ANSWER A

Profit and Loss Summary

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/07	Expense Accounts	194 000	31/07	Revenue Accounts	285 000
31/07	Profit	91 000			
		285 000			285 000

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/07	Drawings	38 000	01/07	Balance	297 000
			31/07	Profit and Loss Summary	91 000

Justification _____

SAMPLE ANSWER B

Profit and Loss Summary

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/07	Expense Accounts	194 000	31/07	Revenue Accounts	287 000
31/07	Capital	93 000			
		287 000			287 000

Capital

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/07	Drawings	38 000	01/07	Balance	350 000
			31/07	Profit and Loss Summary	93 000

Justification _____

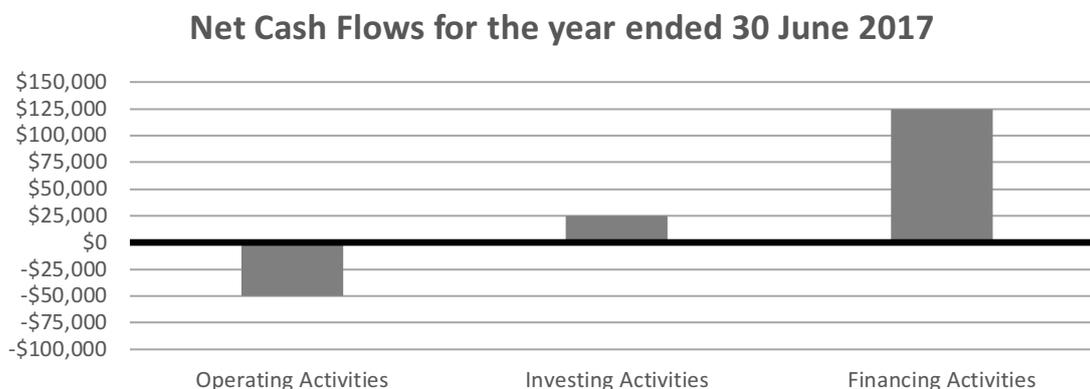
Question 2 (2017 VCAA November Exam Question 7)

D&B Traders has been experiencing difficult trading conditions over the last two years. The business has reported successive losses and the bank ledger account at 1 July 2016 showed a credit balance of \$46 000.

From 1 July 2016, the business began offering credit to customers, resulting in increased sales and a small profit.

During the year ended 30 June 2017, the owner contributed a further \$60 000 cash and did not take any drawings for the year. The owner believes the cash position has improved and that the business is now operating satisfactory.

The following graph shows Net Cash Flows for the year ended 30 June 2017.



Using the information and data provided above, discuss the owner’s belief that the business is now operating satisfactorily.

6 marks

SAMPLE ANSWER A

D&B Traders has seen a decrease in their Net Cash from Operating Activities as the cash outflows relating to the day-to-day trading activities were greater than the cash inflows relating to the day-to-day trading activities.

D&B Traders has seen an increase in their Net Cash from Investing Activities as the cash inflows relating to the disposal of non-current assets were greater than the cash purchases of non-current assets. This would have been due to non-current assets being sold.

D&B Traders has seen an increase in their Net Cash from Financing Activities as the cash inflows relating to changes in their financial structure were greater than the cash outflows relating to changes in the financial structure. This would have been due to both the owner's \$60 000 capital contribution and the further loan borrowings.

As D&B Traders have a large positive cash balance and are reporting an increase in sales and a small profit, the business is operating satisfactorily now as the business' revenues earned are greater than the expenses incurred.

Justification _____

SAMPLE ANSWER B

The introduction of credit to customers resulting in an increase in sales and a small profit is a positive indication of the business' improved trading performance, especially after successive losses.

However, the owner believes that the improved cash position is the indicator that the business is now operating satisfactorily. But what the owner needs to understand is that just because there has been an increase in cash does not necessarily mean that the business is now operating satisfactorily. The owner would not only need to see an increase in profit, but report profits for at least two consecutive periods.

From a cash flow perspective, a worrying result is the negative net cash from operations. Initially, the business would have difficulty expanding by purchasing additional non-current assets or providing the owner with drawings without taking out additional loans or further capital contributions. The owner would need to identify the contributing factors as to why the business has reported a negative net cash from operations. This may simply be a timing issue of Receipts from Accounts Receivable being delayed due to the credit terms offered to customers. Further to this, the business may have purchased a significant quantity of inventory in bulk at a cheaper unit price or invested in an advertising campaign that is expected to improve both the trading performance and cash position of the business in future periods.

A misleading factor that the owner may view as a positive indicator of an improved trading performance is the increase in cash position. The only reason why the business was able to report an increase in cash was due to the positive cash from Financing Activities. As the owner had not taken any Drawings during the period and had made a capital contribution of \$60 000, the remainder of the cash inflow would have come from loan borrowings. This increase in loan borrowings could have a negative impact on the future profitability, liquidity and stability of the business. Further to this, the business has sold non-current assets. This could also have a detrimental effect on the trading performance of the business as their ability to generate revenue could be diminished.

Justification _____

Question 3 (2016 VCAA Exam Question 7)

The accountant of Aime Traders obtained industry average data relating to key financial ratios for the year ended 30 June 2016. The following table compares Aime Traders' ratios with the industry average.

Key Indicator	Aime Traders	Industry Average
Return on Owner's Investment	15.7%	14.9%
Return on Assets	9.9%	12.6%
Asset Turnover	1.9 times	2.2 times
Debt Ratio	54%	34%
Gross Profit Margin	45%	40%
Net Profit Margin	5.2%	5.7%

Discuss the profitability of Aime Traders, as shown by the data above.

6 marks

SAMPLE ANSWER A

Aime Traders' Return on Owner's Investment and Gross Profit Margin are above the industry average. These two results are favourable as Aime Traders are retaining more Gross Profit from each dollar of sales and are providing the owner a greater amount of profit from each dollar of capital invested compared to the industry.

However, Aime Trader's Return on Assets, their Asset Turnover and Net Profit Margin are below the industry average. These three results are unfavourable as Aime Traders' Assets are generating less Sales than competitors, are generating less profit than competitors, and are retaining less Net Profit from each dollar of sales.

Most of Aime Trader's profitability indicators are below their competitors which the owner would view as being unacceptable. However, the main profitability indicator the owner is most interested in is the Return on Owner's Investment. As Aime Trader's Return on Owner's Investment is above their competitors, the owner would view this as a favourable outcome.

Justification _____

SAMPLE ANSWER B

Discuss the profitability of Aime Traders, as shown by the data above.

6 marks

Profitability measures the ability of the business to earn a profit compared to a base figure such as Sales, Assets and Owner's Equity.

A positive indicator of a business' profitability is the return the business can generate using the owner's capital. The Return on Owner's Investment indicator demonstrates that Aime Traders is generating a greater return than their competitors. This is an indicator that an owner is most interested in.

Further to this, Aime Traders' Gross Profit Margin is larger than their competitors. This indicates that they are retaining more Gross Profit from each unit of inventory they sell. This may be due to a selling price that is above competitors and/or Aime Traders are able to source their products from a cheaper supplier.

However, there are profitability indicators which do not compare Aime Traders favourably with their competitors. Aime Traders has a poor Return on Assets indicator compared to the industry average, indicating a poor profitability as the business' assets are not being used as efficiently to generate profit as other businesses.

The same can be said of Aime Traders' Asset Turnover. Even though the business' Gross Profit Margin is higher than the industry average, this has not translated into a higher Asset Turnover. Again, Aime Traders are not using their assets efficiently to generate as much Sales as other businesses.

A further indicator that supports that Aime Traders' profitability is poor compared to their competitors is the Net Profit Margin. The Net Profit Margin indicates that the business is retaining less profit from each dollar of sales. A concerning aspect of their profitability is that their Gross Profit Margin is above the industry average yet their Net Profit Margin falls below the industry average. The concern here is that Aime Traders' expense control is poor.

Justification _____

UNIT 4: RECORDING, REPORTING, BUDGETING AND DECISION

In this unit students further develop their understanding of accounting for a trading business owned by a sole proprietor and the role of accounting as an information system. Students use the double entry system of recording financial data, and prepare reports using the accrual basis of accounting and the perpetual method of inventory recording. Both manual methods and ICT are used to record and report.

Students extend their understanding of the recording and reporting processes, with the inclusion of balance day adjustments and alternative depreciation methods. They investigate both the role and importance of budgeting in decision-making for a business. They analyse and interpret accounting reports and graphical representations to evaluate the performance of a business. Using this evaluation, students suggest strategies to business owners to improve business performance.

Where appropriate, the accounting procedures developed in each area of study should incorporate application of the Conceptual Framework and financial indicators to measure business performance, as well as the ethical considerations, including financial, social and environmental considerations, faced by business owners when making business decisions.

Area of Study 1

In this area of study, students further develop their understanding of the recording and reporting of financial data in the General Journal and General Ledger by focusing on balance day adjustments and the alternative methods of depreciating for non-current depreciable assets. Students prepare accounting reports using manual methods and ICT. They consider the effects of balance day adjustments on the accounting reports, and the implications of using alternative methods of depreciation on the accounting reports and on the performance of the business. They also examine ethical considerations that may affect the recording and reporting of financial data and the effects of these on business performance.

Outcome 1

On completion of this unit, the student should be able to record financial data and balance day adjustments using a double entry system, report accounting information using an accrual-based system, and evaluate the effect of balance day adjustments and alternative methods of depreciation on accounting reports.

To achieve this outcome, the student will draw on key knowledge and key skills outlined in Area of Study 1.

Key knowledge

- accounting assumptions and qualitative characteristics as applicable
- documents used by a business to record financial transactions
- indicators and other relevant information (financial and non-financial) to measure business performance
- the recording of transactions in the General Journal and General Ledger and preparation of classified accounting reports using manual methods and ICT
- the purchase of non-current depreciable assets for cash
- the purchase of non-current depreciable assets financed by a loan
- methods of depreciation: straight-line and reducing balance
- the implications of alternative methods of depreciation on accounting reports
- the recording and reporting on the disposal of a non-current depreciable asset
 - GST will apply to the cash disposal of a non-current asset
 - GST will not apply to a disposal where there is a trade in of a non-current asset
- the recording and reporting of balance day adjustments:
 - prepaid expenses (asset approach) with GST being recorded at the time of payment
 - accrued expenses, with GST being recorded at the time of payment
 - the payment of accrued expenses in the subsequent reporting period
 - unearned revenue (liability approach), with no GST recorded at the time of the deposit
 - accrued revenue, with GST being recorded at the time of receipt
 - receipt of accrued revenue in the subsequent reporting period
- the purpose and preparation of an adjusted Trial Balance
- characteristics and use of classified accounting reports:
 - Cash Flow Statement
 - Income Statement
 - Balance Sheet
- the effects of transactions on the accounting reports
- the distinction between cash and profit
- ethical considerations in relation to the recording and reporting of financial information, and business decision-making

Key skills

- use correct accounting terminology
- explain and apply relevant qualitative characteristics and accounting assumptions
- apply theoretical knowledge to simulated situations
- identify and record financial data and report accounting information
- manually record transactions in the General Journal and General Ledger and prepare accounting reports
- use ICT, including spreadsheets, to record transactions, prepare accounting reports and construct graphical representations
- prepare an adjusted Trial Balance
- analyse the effects of financial transactions on the accounting reports
- use ICT, including spreadsheets, to model and analyse alternative depreciation methods
- compare alternative methods of depreciating non-current assets and justify the method selected
- evaluate the effects of alternative methods of depreciating non-current assets on accounting reports
- analyse the effects of balance day adjustments on accounting reports
- analyse and interpret classified accounting reports, graphical representations and other information to evaluate the performance of a business
- discuss and evaluate ethical considerations in relation to the recording and reporting of financial information, and business decision-making

PURCHASE OF NON-CURRENT ASSETS

An asset is a present economic resource controlled by the business as a result of past events. A non-current asset, such as a Van used for deliveries, is expected to be used by the business for a number of years in the earning of revenue and it is recorded at its cost.

Lewis' Ladders

Lewis Duckworth owns and operates Lewis' Ladders, a small business that commenced on 1 July 2024 and prepares reports on an annual basis on 30 June.

Lewis' Ladders will be the business case study used for the non-current asset section of Unit 4 Area of Study 1.

Purchase of Non-Current Asset with Cash

On 1 July 2024 Lewis' Ladders purchased Office Furniture for \$16 500 including GST.

The purchase of the Office Furniture is recorded as follows.

General Journal

Date	Details	Debit	Credit
01/07	Office Furniture	15 000	
	GST Clearing	1 500	
	Bank		16 500

General Ledger (extract)

Office Furniture

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Bank	15 000			

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Bank	1 500			

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/07	Office Furniture / GST Clearing	16 500

Effect of Office Furniture Purchase on Accounting Equation

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Bank ↓ by \$16 500 / Office Furniture ↑ by \$15 000	Decrease	\$1 500
Liabilities	GST Clearing ↓ by \$1 500	Decrease	\$1 500
Owner's Equity		No Effect	\$0

Purchase of Non-Current Asset with a Loan

Lewis' Ladders

On 1 July 2024 Lewis' Ladders took out a loan to purchase a Van for \$55 000 including GST from MNC Bank.

The receipt of the loan from MNC Bank is recorded as follows.

General Journal

Date	Details	Debit	Credit
01/07	Bank	55 000	
	Loan – MNC Bank		55 000

General Ledger (extract)

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Loan – MNC Bank	55 000			

Loan – MNC Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/07	Bank	55 000

Lewis' Ladders would then use the loan borrowings from MNC Bank to purchase the Van.

General Journal

Date	Details	Debit	Credit
01/07	Van	50 000	
	GST Clearing	5 000	
	Bank		55 000

General Ledger (extract)

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Loan – MNC Bank	55 000	01/07	Van / GST Clearing	55 000

Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Bank	50 000			

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Bank	5 000			

Determining the Cost of a Non-Current Asset

Recording the purchase of a non-current asset may not be as simple as the Office Furniture and Van examples.

The cost of a non-current asset comprises its purchase price (excluding GST) plus any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management that will provide a benefit for the life of the asset.

Exam Tip: Students should be familiar with the definition of the cost of a non-current asset and decide whether items are to be included in the cost of a non-current asset or recorded separately. The 2017 exam required students to calculate the cost price of a pizza oven by adding the installation cost (excluding GST) to the purchase price (excluding GST). Similarly, the 2013 exam required students to decide that a payment for 12 months insurance made for a new generator on the same day it was acquired should not be included in its cost price. When justifying the inclusion of an item in the cost price of an asset, students should not only explain that the item is a cost incurred in getting the asset into a location and condition ready for use to start earning revenue, but also point out that the item is to be included in the cost of the asset as it is expected to provide future economic benefit over the life of the asset.

DEPRECIATION

But before we introduce the concept of depreciation, we need to understand the concept of a depreciable asset.

As a Van has a limited useful life it is considered a depreciable asset. Whereas, Land has an unlimited useful life and therefore is not depreciated.

The useful life is the period over which the Van is expected to be available for use by the business. The estimation of the useful life is a matter of judgement based on the experience of the business with similar assets.

Depreciation is the systematic allocation of the depreciable amount of an asset (cost of the Van excluding GST less its residual value) over its useful life.

The residual value of an asset is the estimated amount the business would expect to receive from disposing the Van at the end of its useful life.

Depreciation Methods

A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. The two methods used in VCE Accounting are the straight-line method and the reducing balance method (diminishing balance method).

The business selects the method that most closely reflects the expected revenue earning pattern and the consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits. At such time, the method shall be changed to reflect the expected pattern.

Exam Tip: Students need to be able to justify the most appropriate depreciation method for different depreciable non-current assets. The VCE Accounting course requires students to also use the expected revenue-earning pattern of the asset as a basis for choosing a depreciation method. If an asset is expected to generate more revenue in its earlier years and less revenue in its later years, the reducing balance method is the most appropriate method. In contrast, if an asset is expected to generate revenue evenly over its useful life, the straight-line method is more appropriate.

STRAIGHT-LINE METHOD OF DEPRECIATION

The straight-line method of depreciation allocates the same amount of an asset's depreciable amount each period.

It assumes that the asset will contribute evenly to revenue each period and is suited to items such as office furniture and shelving.

$$\frac{\text{Historical Cost (excluding GST) less Residual Value}}{\text{Useful Life}} = \text{Annual Depreciation Amount}$$

Lewis' Ladders

Lewis Duckworth owns and operates Lewis' Ladders, a small business that commenced on 1 July 2024 and prepares reports on an annual basis on 30 June.

On 1 July 2024 Lewis' Ladders purchased Office Furniture for \$16 500 including GST. The Office Furniture had a residual value of \$3 000 and a useful life of 8 years.

The depreciation amount for the Office Furniture for the year ended 30 June 2025 is calculated as follows:

$$\frac{\$15\,000 - \$3\,000}{8 \text{ years}} = \$1\,500 \text{ per annum}$$

An adjusting entry on 30 June 2025 is required to record the depreciation expense for the 12 months the Office Furniture has been owned by Lewis' Ladders.

General Journal

Date	Details	Debit	Credit
30/06	Depreciation – Office Furniture	1 500	
	Accumulated Depreciation – Office Furniture		1 500

Exam Tip: When recording a General Journal entry involving depreciation, the name of the asset being depreciated needs to be included. When reporting in the Income Statement and Balance Sheet do not use abbreviations.

Lewis' Ladders

Income Statement (extract) for the year ended 30 June 2025

	\$	\$
Less: Other Expenses		
Depreciation – Office Furniture	1 500	

Exam Tip: Students need to be very familiar with the element definitions and apply them appropriately throughout the course. Students need to choose and apply only the part of definition to the scenario presented. The 2015 exam required students to explain how depreciation satisfies the definition of an expense. Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life. It satisfies the definition of an expense as it decreases assets through an increase in the amount shown for the accumulated depreciation account in the Balance Sheet and it also causes a decrease in Owner's Equity as profit will be decreased when the depreciation expense is allocated in each reporting period. Students who make reference to an increase in liabilities have not applied the definition of an expense to depreciation appropriately.

Lewis' Ladders
Balance Sheet (extract) as at 30 June 2025

	\$	\$
Office Furniture	15 000	
Less: Accumulated Depreciation	1 500	13 500

Exam Tip: The \$13 500 amount reported on the above Balance Sheet extract is called the 'carrying value'. The 'carrying value' is the amount at which an asset is recognised after deducting the accumulated depreciation. The VCE Accounting course requires a student define the 'carrying value' as the amount of depreciation yet to be allocated as an expense during the remaining useful life of the asset plus the estimated residual value, which will not be depreciated during the useful life of the asset.

General Ledger (extract)

Depreciation – Office Furniture

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Accumulated Depreciation – Office Furniture	1 500	30/06	Profit and Loss Summary	1 500
		1 500			1 500

Accumulated Depreciation - Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Balance	1 500	30/06	Depreciation – Office Furniture	1 500
		1 500			1 500
			01/07	Balance	1 500

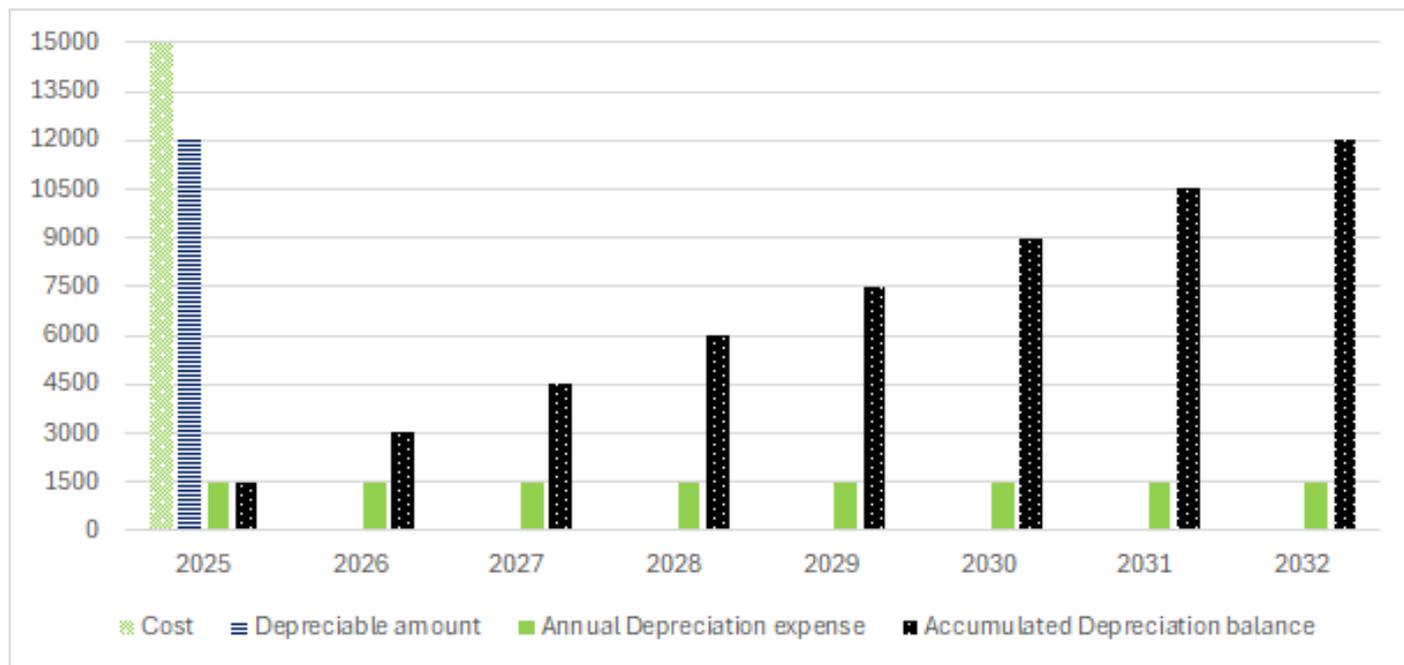
Effect of Depreciation on Accounting Equation

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Office Furniture (Accumulated Depreciation ↑)	Decrease	\$1 500
Liabilities		No Effect	\$0
Owner's Equity	Net Profit (Depreciation – Office Furniture ↑)	Decrease	\$1 500

As a result of the depreciation entry on 30 June 2025, Assets would decrease by \$1 500 as the Accumulated Depreciation would increase by \$1 500. There would be no effect on Liabilities and Owner's Equity (Net Profit) would decrease by \$1 500 as Depreciation – Office Furniture would increase by \$1 500.

Exam Tip: When asked to explain the effect of depreciation on the Balance Sheet., students need to understand that depreciation involves a two-fold effect. Not only will the value of Assets decrease as a result of recording depreciation, but Owner's Equity will also decrease as a result of depreciation expense lowering Net Profit. This ensures that the Accounting equation balances.

A visual representation of the allocation of the Office Furniture’s depreciable amount over its useful life using the straight-line depreciation method appears below.



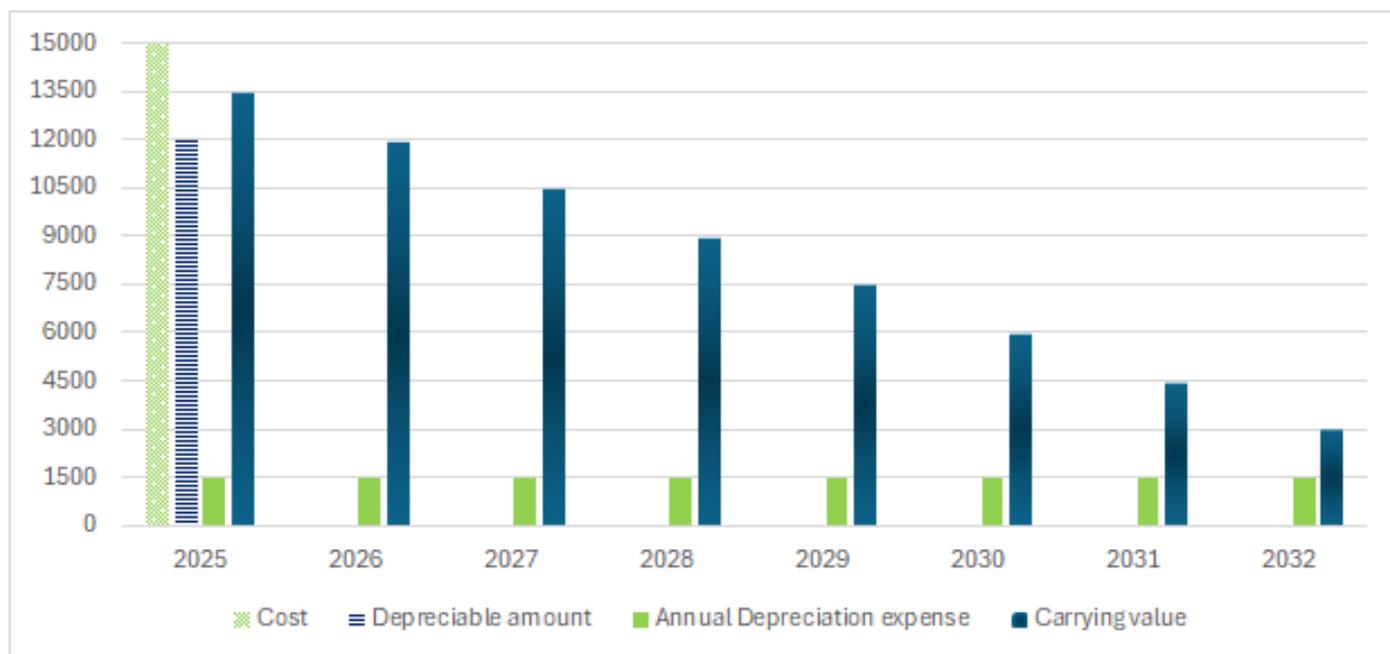
Under the straight-line depreciation method, the annual depreciation expense (\$1 500) remains constant over the Office Furniture’s useful life of 8 years.

The annual increase in the balance of the accumulated depreciation (\$1 500) also remains constant, as expected by the constant depreciation expense.

At the end of the Office Furniture’s useful life of 8 years the balance of the accumulated depreciation (\$12 000) equals the Office Furniture’s depreciable amount.

As the Office Furniture has an estimate residual value of \$3 000 the cost of \$15 000 cannot be fully depreciated.

A second visual representation shows that the carrying value of the Office Furniture at the end of its useful life equals the estimated residual value of \$3 000.



APPLICATION EXERCISE 1

Richie's Rugs

Richie Purnell owns and operates Richie's Rugs, a small business that reports annually on 30 June.

On 1 January 2019 Richie's Rugs bought a Van costing \$32 000 plus GST.

The Van has an effective life of 6 years and a residual value of \$8 000.

- Calculate the depreciation expense for the year ended 30 June 2025.
- Assuming no additional Vans had been purchased, show how the Van would be reported in the Balance Sheet as at 30 June 2026.
- Explain what the carrying value in the Balance Sheet represents.

APPLICATION EXERCISE 1

Shane's Shirts

Shane's Shirts prepares reports on a quarterly basis ending 31 March, 30 June, 30 September and 31 December each year. The accountant provided the following Pre-Adjustment Trial Balance extract as at 30 June 2025.

Shane's Shirts

Pre

Account	Debit	Credit
Accumulated Depreciation - Shelving		7 955
Shelving	19 600	

Additional

- new Shelving was purchased on 1 May 2025 for \$4 800 plus GST
- Shelving is depreciated at a rate of 15% per annum using the straight-line method

- Calculate the depreciation expense for the Shelving for the quarter ended 30 June 2025.

Assuming not further Shelving was purchased or sold, prepare General Journal entries to record the necessary adjustment at 30 September 2025. A narration is not

- Assuming no further Shelving was purchased or sold, show how Shelving would appear in the Balance Sheet as at 30 June 2026.

Download templates to complete all Application Exercises at <https://www.commpap.com/page90-2/>

REDUCING BALANCE METHOD OF DEPRECIATION

The reducing balance method of depreciation allocates more depreciation in an asset's earlier years of use and less depreciation as it ages.

It assumes that the asset is more likely to be more efficient in its earlier years of use and would be expected to generate more revenue in its earlier years and less revenue in its later years.

First Reporting Period

$$\text{Cost (excluding GST)} \times \text{Depreciation Rate} = \text{Annual Depreciation Amount}$$

Second Reporting Period

$$[\text{Cost (excluding GST)} - \text{Accumulated Depreciation from First Reporting Period}] \times \text{Depreciation Rate} \\ = \text{annual depreciation amount}$$

Lewis' Ladders

On 1 July 2024 Lewis' Ladders purchased a Van for \$55 000 including GST.

Lewis is to depreciate the Van using the reducing balance method at a rate of 30% per annum.

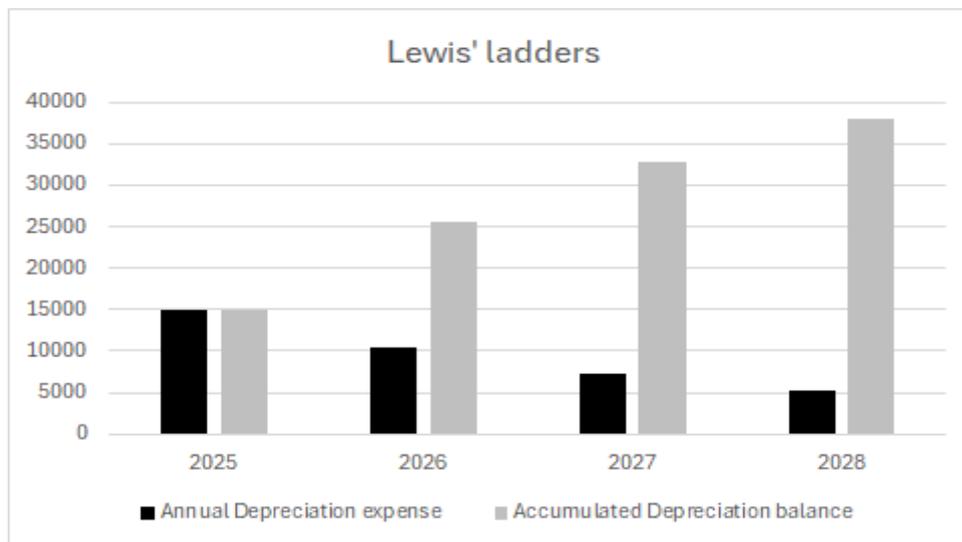
For the year ended 30 June 2025, depreciation expense would be \$15 000 ($\$50\,000 \times 30\%$).

For the year ended 30 June 2026, depreciation expense would be \$10 500 [$(\$50\,000 - \$15\,000) \times 30\%$].

For the year ended 30 June 2027, depreciation expense would be \$7 350 [$(\$50\,000 - \$25\,500) \times 30\%$].

For the year ended 30 June 2028, depreciation expense would be approximately \$5 150 [$(\$50\,000 - \$32\,850) \times 30\%$].

A visual representation of the allocation of the Van's depreciable amount over its useful life using the reducing balance depreciation method appears below.



Exam Tip: Students are regularly asked to interpret visual representations of depreciation over an asset's useful life in exams and identify the depreciation method used. The expense, increase in the accumulated depreciation and decrease in carrying value will be constant when the straight-line method is used. Conversely, the annual depreciation expense and the carrying value decline, together with the increase in the balance of accumulated depreciation will decrease when the reducing balance method is used from one period to the next.

IMPLICATIONS OF ALTERNATIVE METHODS OF DEPRECIATION ON ACCOUNTING REPORTS

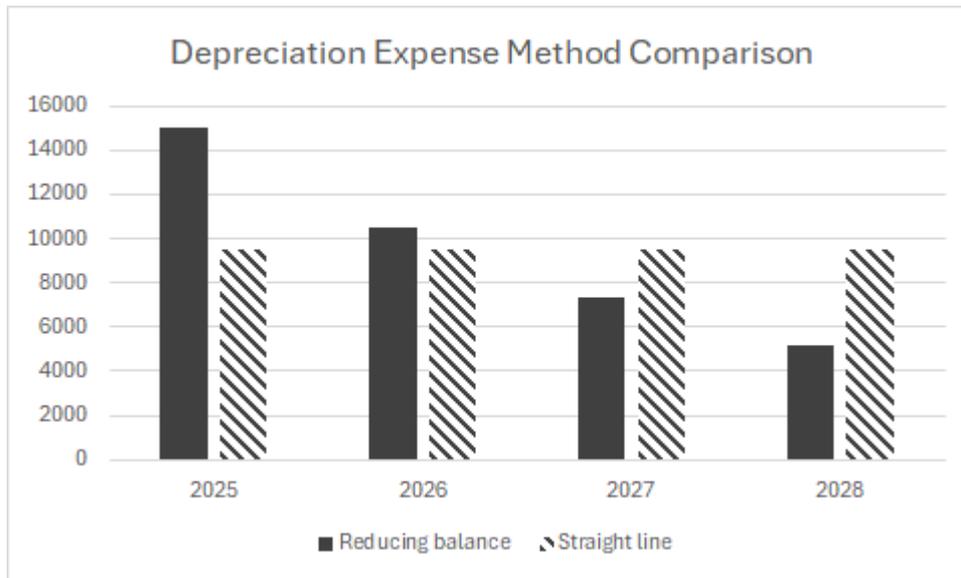
Regardless of which depreciation method is used, the total amount of depreciation allocated as an expense will be the same over an asset's useful life.

Exam Tip: As outlined previously, students are asked in exams to interpret visual representations of depreciation methods. Students can then be asked to explain the effect on accounting reports of choosing one depreciation method compared to another. When given a 'Working Space' in the Answer Booklet, students should include amounts in their explanation of the effect on accounting reports.

Lewis' Ladders

On 1 July 2024 Lewis' Ladders purchased a Van for \$55 000 including GST via a loan from MNC Bank. The Van had a residual value of \$12 000 and a useful life of 4 years.

Lewis decided to depreciate the Van using the reducing balance method at a rate of 30% per annum.



Effect on Income Statement

Year Ended	Reducing Balance Method	Straight-Line Method	Difference
30 June 2025	$\$50\,000 \times 30\% = \$15\,000$	$\frac{\$50\,000 - \$12\,000}{4 \text{ years}} = \$9\,500$	\$5 500

If Lewis depreciated the Van using the reducing balance method instead of the straight-line method for the year ended 30 June 2025, Depreciation Expense would be \$5 500 higher, and Profit would be \$5 500 lower in the Income Statement.

Exam Tip: When explaining the effect depreciation has on accounting reports, students need to think of the two-fold effect depreciation has. In the Income Statement for example, not only do students need to point out that Profit would be lower if the reducing balance method was used in the first year compared using the straight-line method, they also need to add that the reason why Profit is lower is because depreciation expense would be higher.

Effect on Balance Sheet

Lewis' Ladders
Balance Sheet (extract) as at 30 June 2025

	Reducing Balance Method		Straight-Line Method		Difference
	\$	\$	\$	\$	
Van	50 000		50 000		
Less: Accumulated Depreciation	15 000	35 000	9 500	40 500	\$5 500

If Lewis depreciated the Van using the reducing balance method instead of the straight-line method for the year ended 30 June 2025, Assets on the Balance Sheet would be lower by \$5 500 as the balance of Accumulated Depreciation would be higher. In addition to this, Owner's Equity would also be lower by \$5 500 as Profit would be lower due to Depreciation expense being higher in the Income Statement

Effect on Cash Flow Statement

As depreciation expense does not represent a movement of cash there would be impact on the Cash Flow Statement.

Exam Tip: The interpretation of dates in all aspects of Accounting is crucial. In the area of depreciation, particularly the calculation of the reducing balance method, it is often the second year after the initial purchase that is the focus of the calculation. It is a reasonable expectation that students would be able to calculate depreciation expense under both methods. However, it is calculation of the effect on Accounting reports in a subsequent reporting period that causes students concerns.

Effect on Income Statement

Year Ended	Reducing Balance Method	Straight-Line Method	Difference
30 June 2026	$(\$50\,000 - \$15\,000) \times 30\% = \$10\,500$	$\frac{\$50\,000 - \$12\,000}{4 \text{ years}} = \$9\,500$	\$1 000

If Lewis depreciated the Van using the reducing balance method instead of the straight-line method for the year ended 30 June 2026, Depreciation Expense would be \$1 000 higher, and Profit would be \$1 000 lower in the Income Statement.

Effect on Balance Sheet

Lewis' Ladders

Balance Sheet (extract) as at 30 June 2026

	Reducing Balance Method		Straight-Line Method		Difference
	\$	\$	\$	\$	
Van	50 000		50 000		
Less: Accumulated Depreciation	25 500	24 500	19 000	31 000	\$6 500

If Lewis depreciated the Van using the reducing balance method instead of the straight-line method for the year ended 30 June 2026, Assets on the Balance Sheet would be lower by \$6 500 as the balance of Accumulated Depreciation would be higher. In addition to this, Owner's Equity would also be lower by \$6 500 as Capital and Profit would be lower due to Depreciation expense being higher in the Income Statement.

APPLICATION EXERCISE 1

Hutchins' Harps

On 1 January 2025 Hutchins' Harps purchased a Van costing \$35 000 plus GST. The Van is expected to have an estimated useful life of five years and an estimated residual value of \$3 000. The accountant believes the Van should be depreciated using the Straight Line method. Whereas the owner of Hutchins' Harps has been told that the Van should be depreciated using the Reducing Balance method.

- If Hutchins' Harps used the Reducing Balance method of depreciation at a rate of 40% per annum instead of the Straight-Line method, calculate and explain the effect on the Income Statement for the year ending 30 June 2025.
- Assuming no additional Vans had been purchased and that the Reducing Balance method of depreciation is used, show how the Van would be reported in the Balance Sheet as at 30 June 2026.

Download templates to complete all Application Exercises at <https://www.commpap.com/page90-2/>

RECORDING DISPOSAL OF A NON-CURRENT DEPRECIABLE ASSET

A decision may be made by a business owner to either sell an existing non-current depreciable asset for cash or replace it with a new asset via a trade-in.

Disposal for Cash

Lewis' Ladders

Lewis Duckworth owns and operates Lewis' Ladders, a small business that prepares reports on an annual basis. Lewis has provided you with the following Balance Sheet extract as at 30 June 2026.

Lewis' Ladders Balance Sheet (extract) as at 30 June 2026

	\$	\$
Office Furniture	15 000	
Less: Accumulated Depreciation	3 000	12 000

On 30 June 2027 Lewis sold all the Office Furniture for \$8 800 including GST cash.

The \$8 000 proceeds from the disposal of the Office Furniture would be reported in the Cash Flow Statement as follows.

Lewis' Ladders Cash Flow Statement (extract) for the year ended 30 June 2027

	\$	\$
Cash Flows from Investing Activities		
Disposal of Office Furniture	8 000	

Exam Tip: Students need to ensure that they depreciate the non-current depreciable asset up to, and including, the date of disposal. Lewis' Ladders example provides the Balance Sheet extract as at 30 June 2026 even though the Office Furniture was sold on 30 June 2027. Students need to calculate the depreciation expense for the Office Furniture for the year ended 30 June 2027 and update the balance of Accumulated Depreciation accordingly.

The Office Furniture had a residual value of \$3 000 and a useful life of 8 years. Depreciation expense for the year ended 2027 would appear in the General Journal as follows.

General Journal

Date	Details	Debit	Credit
30/06	Depreciation – Office Furniture	1 500	
	Accumulated Depreciation – Office Furniture		1 500

Step 1: Transfer Office Furniture to Disposal of Office Furniture

General Journal

Date	Details	Debit	Credit
30/06	Disposal - Office Furniture	15 000	
	Office Furniture		15 000

General Ledger (extract)**Office Furniture**

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Balance	15 000	30/06	Disposal – Office Furniture	15 000

Disposal – Office Furniture

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Office Furniture	15 000			

Step 2: Transfer Accumulated Depreciation - Office Furniture to Disposal of Office Furniture**General Journal**

Date	Details	Debit	Credit
30/06	Accumulated Depreciation - Office Furniture	4 500	
	Disposal - Office Furniture		4 500

General Ledger (extract)**Accumulated Depreciation – Office Furniture**

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Disposal – Office Furniture	4 500	01/07	Balance	3 000
			30/06	Depreciation Expense – Office Furniture	1 500
					4 500

Disposal – Office Furniture

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Office Furniture	15 000	30/06	Accumulated Depreciation - Office Furniture	4 500

Step 3: Record receipt of cash from disposing Office Furniture**General Journal**

Date	Details	Debit	Credit
30/06	Bank	8 800	
	Disposal - Office Furniture		8 000
	GST Clearing		800

General Ledger (extract)

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Disposal – Office Furniture / GST Clearing	8 800			

Disposal – Office Furniture

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Office Furniture	15 000	30/06	Accumulated Depreciation - Office Furniture	4 500
			30/06	Bank	8 000

Step 4: Determine whether there was a Profit or Loss from disposing Office Furniture

The first way would be to compare the Carrying Amount of the Office Furniture on the date it was sold with the cash received.

As the Carrying Amount of the Office Furniture was \$10 500 as at 30 June 2027 and the cash received was \$8 000 the business made a loss of \$2 500.

Exam Tip: Another way to determine if the business made a profit or loss from selling a non-current asset is to 'balance' the Disposal temporary ledger account in a similar way to balancing a ledger account. If the 'balancing' entry required is on the credit side, the business made a loss. If the 'balancing' entry required is on the debit side, the business made a profit.

Disposal – Office Furniture

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Office Furniture	15 000	30/06	Accumulated Depreciation - Office Furniture	4 500
			30/06	Bank	8 000
					2 500
		15 000			15 000

To 'balance' the Disposal – Office Furniture temporary ledger account or record the Loss on Disposal – Office Furniture, the following entry is required.

General Journal

Date	Details	Debit	Credit
30/06	Loss on Disposal – Office Furniture	2 500	
	Disposal - Office Furniture		2 500

General Ledger (extract)

Loss on Disposal – Office Furniture

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Disposal – Office Furniture	2 500	30/06	Profit and Loss Summary	2 500
		2 500			2 500

Disposal – Office Furniture

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Office Furniture	15 000	30/06	Accumulated Depreciation - Office Furniture	4 500
			30/06	Bank	8 000
			30/06	Loss on Disposal – Office Furniture	2 500
		15 000			15 000

Exam Tip: It is recommended that when posting transactions to a Revenue or Expense account, the account should then be closed to the Profit and Loss Summary account. Students can be asked to 'complete' a ledger account. Simply posting the transactions is not completing the account. The account should be closed and the final total written in both Amount columns on the final line of the account.

The loss of \$2 500 from the sale of the Office Furniture would be reported in the Income Statement as follows.

Lewis' Ladders

Income Statement (extract) for the year ended 30 June 2027

	\$	\$
Other Expenses		
Loss on Disposal - Office Furniture	2 500	

Lewis's Ladders made a loss on selling the Office Furniture as they had under-depreciated the Office Furniture due to overestimating the residual value or useful life.

Exam Tip: As the proceeds from the disposal were less than the carrying value is not the reason why Lewis' Ladders made a loss. This is how the loss was calculated.

Disposal via Trade-In

A trade-in occurs when a business exchanges the old non-current depreciable asset for a new non-current depreciable asset. The amount paid for the new asset is reduced by the fair value of the old asset.

Lewis' Ladders

Lewis Duckworth owns and operates Lewis' Ladders, a small business that prepares reports on an annual basis. Lewis has provided you with the following Balance Sheet extract as at 30 June 2026.

Lewis' Ladders
Balance Sheet (extract)
as at 30 June 2026

	\$	\$
Van	50 000	
Less: Accumulated Depreciation	25 500	24 500

On 30 June 2027 Lewis traded-in the Van for a new Van costing \$47 300 including GST.

The fair value of the old Van traded-in was \$20 000.

The Van is depreciated using the reducing balance method of depreciation at an annual rate of 30% per annum.

Depreciation expense for the year ended 2027 would appear in the General Journal as follows.

General Journal

Date	Details	Debit	Credit
30/06	Depreciation – Van	7 350	
	Accumulated Depreciation – Van		7 350
	(\$24 500 x 30% = 7 350)		

Exam Tip: Regardless of whether the asset is sold for cash or traded-in the first two steps in the recording process are the same. The calculation and recording of a profit or loss on the disposal of the asset are the same. The difference occurs when recording the cash proceeds compared to recording the fair value of the trade-in and the subsequent recording of the new asset purchased. Students need to be familiar with recording the General Journal entries and preparing the General Ledger accounts for both methods.

Step 1: Transfer Van to Disposal of Van

General Journal

Date	Details	Debit	Credit
30/06	Disposal – Van	50 000	
	Van		50 000

General Ledger (extract)

Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Balance	50 000	30/06	Disposal – Van	50 000

Disposal – Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Van	50 000			

Step 2: Transfer Accumulated Depreciation - Van to Disposal of Van

General Journal

Date	Details	Debit	Credit
30/06	Accumulated Depreciation – Van	32 850	
	Disposal - Van		32 850

General Ledger (extract)

Accumulated Depreciation – Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Disposal – Van	32 850	01/07	Balance	25 500
			30/06	Depreciation Expense – Van	7 350
					32 850

Disposal – Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Van	50 000	30/06	Accumulated Depreciation - Van	32 850

Step 3: Record fair value of traded-in Van

Even though this transaction does not involve an exchange of cash, it does involve an exchange of non-current depreciable asset (Van). The fair value amount is effectively the cash received if the business sold the Van to a dealer and the business then used that cash received to purchase a new Van from the same dealer.

General Journal

Date	Details	Debit	Credit
30/06	Van	20 000	
	Disposal - Van		20 000

General Ledger (extract)

Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Balance	50 000	30/06	Disposal – Van	50 000
30/06	Disposal of Van	20 000			

Disposal – Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Van	50 000	30/06	Accumulated Depreciation - Van	32 850
			30/06	Van	20 000

Step 4: Determine whether there was a Profit or Loss from trading-in Van

Disposal – Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Van	50 000	30/06	Accumulated Depreciation - Van	32 850
		2 850	30/06	Van	20 000
		52 850			52 850

To 'balance' the Disposal – Van temporary ledger account or record the Loss on Disposal – Van, the following entry is required.

General Journal

Date	Details	Debit	Credit
30/06	Disposal – Van	2 850	
	Profit on Disposal - Van		2 850

General Ledger (extract)

Disposal – Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Van	50 000	30/06	Accumulated Depreciation - Van	32 850
30/06	Profit on Disposal - Van	2 850	30/06	Van	20 000
		52 850			52 850

Profit on Disposal – Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Profit and Loss Summary	2 850	30/06	Disposal – Van	2 850
		2 850			2 850

The profit of \$2 850 from the trade-in of the Van would be reported in the Income Statement as follows.

Lewis' Ladders

Income Statement (extract) for the year ended 30 June 2027

	\$	\$
Other Revenue		
Profit on Disposal - Van	2 850	

Exam Tip: As the proceeds from the disposal were greater than the carrying value is not the reason why Lewis' Ladders made a profit. This is how the profit was calculated. Lewis' Ladders made a profit on trading-in the Van as they had overdepreciated the Van due to underestimating the residual value or useful life. Students should not respond with a generic statement about the asset being underdepreciated or overdepreciated due to underestimating or overestimating the residual value or effective life. The response needs to be specific about whether the asset was underdepreciated OR whether the asset was overdepreciated due to the residual value or useful life being underestimated OR overestimated respectively.

APPLICATION EXERCISE 1

Anna's Air

Anna Palaszczuk owns and operates Anna's Air-Conditioning, a small business that prepares reports on an annual basis on 30 June each year. Anna started her business on 1 January 2024 with the purchase of Shelving for \$16 800.

Shelving is depreciated at a rate of 20% per annum using the straight-line method. Shelving that originally cost \$5 700 was sold for \$3 300 including GST cash on 31 October 2025.

- Calculate the accumulated depreciation amount of the Shelving sold as at 31 October 2025.
- Show how the Disposal of Shelving account would appear in the General Ledger as at 31 October 2025.
- Explain why a profit or loss on disposal of Shelving occurred.

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PRE-ADJUSTMENT TRIAL BALANCE

The purpose of preparing a Pre-adjustment Trial Balance is to check that the total debit entries equal the total credit entries in the General Ledger accounts.

The Pre-adjustment Trial Balance helps to identify any errors in the recording process so that they can be identified and rectified before reports are prepared.

Exam Tip: Understanding the purpose of preparing a Pre-Adjustment Trial Balance is important and students in past examinations have performed poorly in this respect. For example, in the 2017 exam, 71% of students received zero marks out of two for a question requiring them to demonstrate an understanding of the purpose of preparing a Trial Balance.

Kevin's Keyboards

Pre-adjustment Trial Balance as at 30 June 2025

Account	Debit	Credit
Accounts Payable		10 780
Accounts Receivable	23 170	
Accrued Interest Revenue	200	
Accumulated Depreciation – Equipment		3 190
Accumulated Depreciation – Premises		20 300
Advertising	1 900	
Allowance for Doubtful Debts		970
Bank	5 850	
Capital		805 090
Cash Sales		17 100
Cost of Sales	30 840	
Credit Sales		60 360
Delivery Inwards	1 420	
Delivery Outwards	890	
Discount Expense	132	
Discount Revenue		198
Drawings	4 700	
Equipment	13 600	
GST Clearing		614

Inventory	34 750	
Land	450 000	
Premises	336 000	
Prepaid Insurance Expense	2 000	
Sales Returns	2 860	
Term Deposit	20 000	
Unearned Rent Revenue		10 800
Unearned Sales Revenue		4 000
Wages	5 090	
Totals	933 402	933 402

The Income Statement for the quarter ended 30 June 2025 for Kevin's Keyboards using the Pre-adjustment Trial Balance would appear as follows.

Kevin's Keyboards
Income Statement for the quarter ending 30 June 2025

	\$	\$
Revenues		
Cash Sales	17 100	
Credit Sales	60 360	
Less: Sales Returns	2 860	74 600
Less: Cost of Goods Sold		
Cost of Sales	30 840	
Delivery Inwards	1 420	32 260
Gross Profit		42 340
Plus: Other Revenues		
Discount Revenue		198
		42 538
Less: Other Expenses		
Advertising	1 900	
Delivery Outwards	890	
Discount Expense	132	
Wages	5 090	8 012
Net Profit / (Loss)		34 526

Using the Pre-adjustment Trial Balance to prepare the Income Statement for the quarter ended 30 June 2025 would not satisfy the Accrual Basis Assumption or the Period Assumption.

Under the Accrual Basis Assumption, revenue is recognised in the period it is earned. Similarly, expenses are recognised when they are incurred. Accrual basis profit for an accounting period is determined by subtracting expenses incurred for a period from revenue earned in that same period.

The profit of \$34 526 reported in Kevin's Keyboards' Income Statement is not an accurate reflection of the trading performance of the business for the quarter ended 30 June 2025 as the revenues reported do not reflect the revenues earned, nor do the expenses reported reflect the expenses incurred.

In order to report relevant information that helps users make decisions, the most accurate profit needs to be calculated. On the final date of the reporting period, otherwise known as 'balance day', adjustments need to be made to revenue and expense accounts via the General Journal so that they reflect the revenues earned and expenses incurred, not just the cash received and the cash paid.

Kevin's Keyboards for the quarter ended 30 June 2025 will be the business case study used for the remainder of Unit 4 Area of Study 1.

PREPAID EXPENSES

A prepaid expense is when a business pays an expense in advance. For example, a payment for an expense may be made in one reporting period (December 2024) but relates to an expense that will be consumed in a future reporting period (January 2025).

Kevin's Keyboards

On 1 January 2025 Kevin's Keyboards paid \$2 640 including GST for an annual insurance policy ending 31 January 2026. (EFT 3762)

General Journal

Date	Details	Debit	Credit
01/01	Prepaid Insurance Expense	2 400	
	GST Clearing	240	
	Bank		2 640

General Ledger (extract)

Prepaid Insurance Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Bank	2 400			

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Bank	240			

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/01	Prepaid Insurance / GST Clearing	2 640

This payment would be reported on the Balance Sheet of Kevin's Keyboards as at 31 March 2025 as a Current Asset.

The Prepaid Insurance Expense is a Current Asset as it is a present economic resource controlled by the entity as a result of past events where it is reasonably expected to be consumed within 12 months after the end of the reporting period.

Effect of Payment on Accounting Equation

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Prepaid Insurance Expense ↑ by \$2 400 / Bank ↓ by \$2 640	Decrease	\$240
Liabilities	GST Clearing	Decrease	\$240
Owner's Equity		No Effect	\$0

What needs to happen on 31 March 2025?

As 31 March 2025 is the final date of the reporting period, or 'balance day', an adjusting entry via the General Journal is necessary to ensure the Insurance Expense General Ledger account reflects the expense incurred for the reporting period, not necessarily the amount of Insurance Expense paid.

Exam Tip: The key to successfully completing balance day adjustments, like many areas in Accounting, are the dates provided in the question. Often the date of the payment of an expense in advance is different to the date the payment for the expense in advance begins to be consumed. In the Kevin's Keyboards example, just because the payment for insurance was made on 1 January 2025 does not mean that the insurance expense begins to be consumed from 1 January 2025. As the annual insurance policy ends on 31 January 2026, students need to step 12 months backwards from the end date to determine the start date (31 January 2026 less 12 months = 1 February 2025).

The Pre-adjustment Trial Balance for Kevin's Keyboards as at 31 March 2025 would appear as follows.

Kevin's Keyboards Pre-adjustment Trial Balance (extract) as at 31 March 2025

Account	Debit	Credit
Prepaid Insurance Expense	2 400	

The payment made excluding GST of \$2 400 provides the business with 12 months of future economic benefit commencing 1 February 2025 and will be consumed at a rate of \$200 per month.

As at 31 March 2025 both February and March need to be reported in the Income Statement as an expense incurred.

General Journal

Date	Details	Debit	Credit
31/03	Insurance Expense	400	
	Prepaid Insurance Expense		400

General Ledger (extract)

Insurance Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/03	Prepaid Insurance Expense	400	31/03	Profit and Loss Summary	400
		400			400

Prepaid Insurance Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/01	Bank	2 400	31/03	Insurance Expense	400
			31/03	Balance	2 000
		2 400			2 400
01/04	Balance	2 000			

Effect of Prepaid Insurance Expense Adjustment on Accounting Equation

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Prepaid Insurance Expense	Decrease	\$400
Liabilities		No Effect	\$0
Owner's Equity	Net Profit (Insurance Expense)	Decrease	\$400

What needs to happen on 30 June 2025?

The Pre-adjustment Trial Balance for Kevin's Keyboards as at 30 June 2025 would appear as follows.

Kevin's Keyboards

Pre-adjustment Trial Balance (extract) as at 30 June 2025

Account	Debit	Credit
Prepaid Insurance Expense	2 000	

As no payment for Prepaid Insurance Expense has been recorded during the quarterly reporting period ended 30 June 2025, the balance in the Pre-adjustment Trial Balance as at 30 June 2025 is the opening balance of the Prepaid Insurance Expense ledger as at 1 April 2025.

As at 30 June 2025 three more months (April, May and June) of the ten months remaining prepaid as at 1 April 2025 have been consumed and need to be reported in the Income Statement as an expense incurred.

General Journal

Date	Details	Debit	Credit
30/06	Insurance Expense	600	
	Prepaid Insurance Expense		460

General Ledger (extract)

Insurance Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Prepaid Insurance Expense	600	30/06	Profit and Loss Summary	600
		600			600

Prepaid Insurance Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/04	Balance	2 000	30/06	Insurance Expense	600
			30/06	Balance	1 400
		2 000			2 000
01/07	Balance	1 400			

ACCRUED EXPENSES (No GST)

An accrued expense is an expense incurred in the current reporting period (June 2025) but will not be paid until a future reporting period (July 2025).

The balance of an Other Expense account in a Pre-adjustment Trial Balance (except for non-cash expenses and potentially Advertising) represents the amount paid during the reporting period.

Kevin's Keyboards

Pre-adjustment Trial Balance (extract) as at 30 June 2025

Account	Debit	Credit
Wages	5 090	

General Ledger (extract)

Wages

Date	Cross-reference	Amount	Date	Cross-reference	Amount
20/04	Bank	1 240			
10/05	Bank	1 300			
30/05	Bank	1 030			
19/06	Bank	1 520			
		5 090			

As at 30 June 2025 Kevin's Keyboards owed \$1 280 of Wages and would be recorded as follows.

General Journal

Date	Details	Debit	Credit
30/06	Wages	1 280	
	Accrued Wages		1 280

The recording of an accrued expense as a balance day adjustment creates a Current Liability as the amount of Wages owing represents 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 of the end of the reporting period.

Effect of recording an Accrued Expense on Accounting Equation

Element	Items Increased / Decreased	Overall Effect	Amount
Assets		No Effect	\$0
Liabilities	Accrued Wages	Increase	\$1 280
Owner's Equity	Net Profit (Wages Expense)	Decrease	\$1 280

The balance of an expense account in a Post-adjustment Trial Balance represents the amount incurred during the reporting period.

Kevin's Keyboards

Post-adjustment Trial Balance (extract) as at 30 June 2025

Account	Debit	Credit
Accrued Wages		1 280
Wages	6 370	

General Ledger (extract)

Wages

Date	Cross-reference	Amount	Date	Cross-reference	Amount
20/04	Bank	1 240	30/06	Profit and Loss Summary	6 370
10/05	Bank	1 300			
30/05	Bank	1 030			
19/06	Bank	1 520			
30/06	Accrued Wages	1 280			
		6 370			6 370

Accrued Wages

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Balance	1 280	30/06	Wages	1 280
		1 280			1 280
			01/07	Balance	1 280

ACCRUED EXPENSES (With GST)

Exam Tip: In the VCE Accounting course, the GST associated with an accrued expense is recorded at the time of payment. Therefore, any GST associated with an expense owing at the end of a reporting period is effectively ignored when determining the amount to be recorded as a balance day adjustment.

Kevin's Keyboards

Pre-adjustment Trial Balance (extract) as at 30 June 2025

Account	Debit	Credit
Advertising	1 900	

General Ledger (extract)

Advertising

Date	Cross-reference	Amount	Date	Cross-reference	Amount
18/04	Bank	650			
25/05	Inventory	400			
03/06	Bank	850			
		1 900			

As at 30 June 2025 Lewis' Ladders owed \$990 including GST of Advertising and would be recorded as follows.

General Journal

Date	Details	Debit	Credit
30/06	Advertising	900	
	Accrued Advertising		900

The balance of an expense account in a Post-adjustment Trial Balance represents the amount incurred during the reporting period.

Kevin's Keyboards

Post-adjustment Trial Balance (extract) as at 30 June 2025

Account	Debit	Credit
Accrued Advertising		900
Advertising	2 800	

General Ledger (extract)

Advertising

Date	Cross-reference	Amount	Date	Cross-reference	Amount
18/04	Bank	1 050	30/06	Profit and Loss Summary	2 800
03/06	Bank	850			
30/06	Accrued Advertising	900			
		2 800			2 800

Accrued Advertising

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Balance	900	30/06	Advertising	900
		900			900
			01/07	Balance	900

A key knowledge and key skill of Unit 4 Outcome 1 relates to students discussing and evaluating ethical considerations in relation to business decision-making and the recording and reporting of financial information.

Accountants need to ensure that the Accounting Assumptions and Qualitative Characteristics have been followed when preparing and presenting financial statements to users for the purpose of making and evaluating decisions regarding the allocation of their economic resources.

For instance, the Period Assumption, together with the Relevance characteristic, requires all transactions that have occurred during the period to be included should the information be capable of making a difference to the decisions made by users.

An accountant may be faced with the dilemma to understate a business' revenues and overstate a business' expenses in order to minimise the amount of income tax levied. This can be achieved through the deliberate deferring of revenue to future reporting periods or increasing expenses through the reporting of accrued expenses.

Alternatively, an accountant may be pressured to ensure the financial statements presented to a Bank when applying for a loan demonstrate a trading performance and position that will give the business the best possible chance of the loan application being successful. This can be achieved through recognising revenue even though it has not been earned or through the deliberate deferring of expenses to future reporting periods by not recording each accrued expense. This will make the profit on the Income Statement overstated and the liabilities on the Balance Sheet understated.

Accountants are required at all times to act in the public interest by complying with Assumptions and Characteristics when recording and reporting financial information.

PAYMENT OF ACCRUED EXPENSES IN THE SUBSEQUENT REPORTING PERIOD

The recording of a payment of an expense item may not necessarily result in the amount excluding GST being entirely debited to the expense account.

Part of the payment of the expense item may relate to the expense that has been incurred and recorded in a previous reporting period (Accrued Expense).

Kevin's Keyboards

Post-adjustment Trial Balance (extract) as at 30 June 2025

Account	Debit	Credit
Accrued Wages		1 280

On 10 July 2025 Lewis' Ladders paid \$2 040 of Wages. (EFT 3482)

Instead of allocating the entire \$2 040 paid to the Wages expense ledger in the reporting period the payment was made, the balance of Accrued Wages as at 30 June 2025 needs to be subtracted from the payment amount first, with any remaining amount allocated the Wages expense ledger.

General Journal

Date	Details	Debit	Credit
10/07	Accrued Wages	1 280	
	Wages	760	
	Bank		2 040

General Ledger (extract)

Accrued Wages

Date	Cross-reference	Amount	Date	Cross-reference	Amount
10/07	Bank	1 280	01/07	Balance	1 280

Wages

Date	Cross-reference	Amount	Date	Cross-reference	Amount
10/07	Bank	760			

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			10/07	Accrued Wages / Wages	2 040

Effect of Wages Payment on Accounting Equation

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Bank	Decrease	\$2 040
Liabilities	Accrued Wages	Decrease	\$1 280
Owner's Equity	Net Profit (Wages ↑)	Decrease	\$760

Kevin's Keyboards
Post-adjustment Trial Balance (extract) as at 30 June 2025

Account	Debit	Credit
Accrued Advertising		900

On 19 July 2025 Kevin's Keyboards paid \$1 650 including GST for Advertising.

General Journal

Date	Details	Debit	Credit
19/07	Accrued Advertising	900	
	Advertising	600	
	GST Clearing	150	
	Bank		1 650

General Ledger (extract)

Accrued Advertising

Date	Cross-reference	Amount	Date	Cross-reference	Amount
19/07	Bank	900	01/07	Balance	900

Advertising

Date	Cross-reference	Amount	Date	Cross-reference	Amount
19/07	Bank	600			

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
19/07	Bank	150			

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			19/07	Accrued Advertising / Advertising / GST Clearing	1 650

Effect of Advertising Payment on Accounting Equation

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Bank	Decrease	\$1 650
Liabilities	Accrued Advertising ↓ by \$900 / GST Clearing ↓ by \$150	Decrease	\$1 050
Owner's Equity	Net Profit (Advertising Expense ↑)	Decrease	\$600

APPLICATION EXERCISE

Lisa's Ladders

Lisa Vanna owns and operates Lisa's Ladders, a small business that applies a fixed mark-up of 200% and prepares reports on a quarterly basis.

Lisa has provided the following Pre-Adjustment Trial Balance extract as at 31 March 2025.

Lisa's Ladders

Pre

Account	Debit	Credit
Loan – OTI Bank		25 000
Prepaid Rent Expense	38 600	
Inventory	33 490	

Additional information

- Loan from OTI is an interest only loan charged at a rate of 6% per annum. Interest is paid on a half-yearly basis on 31 May and 30 November each year.
- Rent is paid yearly in advanced. The most recent payment of \$33 600 plus GST was made on 1 February 2025 for the year ending 28 February 2026.
- On 16 March 2025 Lisa took 2 'Accomplish' ladders for personal use. Each of these ladders had a selling price of \$1 056 including GST. This event had not been recorded.
- As at 31 March 2025 Advertising for \$2 640 including GST remains unpaid.
- Physical inventory count determined value of inventory on hand as at 31 March 2025 as \$30 000.

Prepare General Journal entries to record the necessary adjustments at 31 March 2025. Narrations are not

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UNEARNED REVENUE

Unearned revenue occurs when a business receives cash in advance even though the business has not earned the revenue yet.

Kevin's Keyboards

Kevin's Keyboards owns the premises the store operates in.

Kevin's Keyboards has negotiated with Greg Greatson to rent the recording studio and teaching space on the second level of the premises starting 1 May 2025.

Kevin's Keyboards received \$11 880 including GST from Greg Greatson on 1 April 2025 for the six-month rental period ending 31 October 2025.

Reports are prepared quarterly for the periods ended 30 September, 31 December, 31 March and 30 June.

The receipt of the rental payment from Greg Greatson would be recorded as follows.

General Journal

Date	Details	Debit	Credit
01/04	Bank	11 880	
	Unearned Rent Revenue		10 800
	GST Clearing		1 080

General Ledger (extract)

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/04	Unearned Rent Revenue / GST Clearing	11 880			

Unearned Rent Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/04	Bank	10 800

GST Clearing

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			01/04	Bank	1 080

The receipt of the Unearned Rent Revenue for the six-month period ended 31 October 2025 would be reported initially on the Balance Sheet of Kevin's Keyboards as a Current Liability.

The Unearned Rent Revenue is a Current Liability as it is a present obligation of the business as a result of past events where it is reasonably expected to transfer an economic resource within 12 months of the end of the reporting period.

What needs to happen on 30 June 2025?

As 30 June 2025 is the final date of the reporting period, or 'balance day', an adjusting entry via the General Journal is necessary to ensure the Rent Revenue General Ledger account reflects the revenue earned for the reporting period, not just the Rent Revenue received.

General Journal

Date	Details	Debit	Credit
30/06	Unearned Rent Revenue	3 600	
	Rent Revenue		3 600

General Ledger (extract)

Unearned Rent Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Rent Revenue	3 600	01/04	Bank	10 800
30/06	Balance	3 600			
		10 800			10 800
			01/07	Balance	3 600

Rent Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Profit and Loss Summary	3 600	30/06	Unearned Rent Revenue	3 600
		3 600			3 600

Effect of Rent Revenue Adjustment on Accounting Equation

Element	Items Increased / Decreased	Overall Effect	Amount
Assets		No Effect	\$0
Liabilities	Unearned Rent Revenue	Decrease	\$3 600
Owner's Equity	Net Profit (Rent Revenue)	Increase	\$3 600

Unearned Sales Revenue

Unearned Sales Revenue occurs when a business receives a cash deposit from a customer on the day they place an order for goods to be supplied at a later date.

A business would require a non-refundable deposit from a customer when the goods are not currently available and are required to be purchased with the business possibly incurring significant delivery and insurance costs. The charging of deposit ensures that the business purchasing the goods is not financially disadvantaged should the customer change their mind and not purchase the goods.

Kevin's Keyboards

Kevin Nguyen owns and operates Kevin's Keyboards, a small business that applies a fixed mark-up of 150%.

Reports are prepared quarterly for the periods ended 30 September, 31 December, 31 March and 30 June.

On 16 March 2025 Kevin's Keyboards received an order from The Kennedy Centre for three 'Schimmel' pianos.

Kevin's Keyboards sells each 'Schimmel' piano for \$16 500 including GST.

The Kennedy Centre were then issued receipt 567 when they paid a \$2 500 deposit.

Kevin's Keyboards would record the receipt of the \$2 500 deposit as follows.

General Journal

Date	Details	Debit	Credit
16/03	Bank	2 500	
	Unearned Sales Revenue		2 500

General Ledger (extract)

Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
16/03	Unearned Sales Revenue	2 500			

Unearned Sales Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
			16/03	Bank	2 500

Effect of Receipt on Accounting Equation

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Bank	Increase	\$2 500
Liabilities	Unearned Sales Revenue	Increase	\$2 500
Owner's Equity		No Effect	\$0

The receipt of the deposit would be reported on the Balance Sheet of Kevin's Keyboards as at 31 March 2025 as a Current Liability.

The Unearned Sales Revenue is a Current Liability as it is a present obligation of the business as a result of past events where it is reasonably expected to transfer an economic resource within 12 months of the end of the reporting period.

Kevin's Keyboards

Balance Sheet (extract) as at 31 March 2025

	\$	\$
Current Liabilities		
Unearned Sales Revenue	2 500	

The receipt of the deposit would be reported in the Cash Flow Statement of Kevin's Keyboards for the quarter ended 31 March 2025 as an Operating Inflow.

Kevin's Keyboards

Cash Flow Statement (extract) for the quarter ended 31 March 2025

	\$	\$
Net Cash from Operating Activities		
Unearned Sales Revenue	2 500	

On 22 May 2025 Kevin's Keyboards delivered the three 'Schimmel' pianos to The Kennedy Centre and issued invoice 284. Note that it is often just the first two entries that students are required to record in the General Journal.

General Journal

Date	Details	Debit	Credit
22/05	Unearned Sales Revenue	2 500	
	Credit Sales		2 500
	Credit Sales		42 500
	GST Clearing		4 500
	Accounts Receivable	47 000	
	Cost of Sales	18 000	
	Inventory		18 000

General Ledger (extract)

Unearned Sales Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
22/05	Credit Sales	2 500	01/04	Balance	2 500
30/06	Balance	1 500	28/04	Bank*	1 500
		4 000			4 000
			01/07	Balance	1 500

* The Bank entry on 28 April is for illustrative purposes only and is not linked to the order from The Kennedy Centre.

Interest Revenue

When a business has a cash balance available that is not needed in the short term, decisions need to be made in terms of how best to use these funds.

Options available include paying outstanding Accounts Payable balances promptly in order to receive a discount, repaying loans in order to reduce the amount of interest charged or replacing idle non-current assets in an attempt to generate additional revenue.

Another option would be to effectively 'lend' these funds with a financial institution for a fixed period of time. In return, the business would receive interest payments from the financial institution as compensation for 'lending' it the business' funds. Financial institutions refer to this arrangement as a Term Deposit.

Kevin's Keyboards

Kevin Nguyen owns and operates Kevin's Keyboards, a small business that prepares reports on a quarterly basis ending 30 September, 31 December, 31 March and 30 June.

On 1 February 2025 Kevin's Keyboards invested \$20 000 in a Term Deposit with MNC Bank for 36 months earning 6% per annum. MNC Bank pays interest on a half-yearly basis from the date the Term Deposit starts.

What needs to happen on 31 March 2025?

As 31 March 2025 is the final date of the reporting period, or 'balance day', an adjusting entry via the General Journal is necessary to ensure the Interest Revenue General Ledger account reflects the revenue earned for the reporting period, even though no Interest Revenue has been received.

Term Deposit Amount x Interest Rate % = Annual Interest Revenue

$\$20\,000 \times 6\% = \$1\,200$ Interest Revenue per annum

$\frac{\$1\,200}{12} = \100 Interest Revenue per month

Kevin's Keyboards started the Term Deposit on 1 February 2025.

The first of two \$600 interest payments is due to be received on 31 July 2025.

As at 31 March 2025 two months of interest revenue (February and March) have been earned. This interest revenue is required to be included in the Income Statement for the quarter ended 31 March 2025 even though the interest will not be received until 31 July 2025.

General Journal

Date	Details	Debit	Credit
31/03	Accrued Interest Revenue	200	
	Interest Revenue		200

General Ledger (extract)

Accrued Interest Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/03	Interest Revenue	200	31/03	Balance	200
		200			200
01/04	Balance	200			

Interest Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
31/03	Profit and Loss Summary	200	31/03	Accrued Interest Revenue	200
		200			200

This Accrued Interest Revenue owing would be reported on the Balance Sheet of Kevin's Keyboards as at 31 March 2025 as a Current Asset.

The Accrued Interest Revenue is a Current Asset as it is a present economic resource controlled by the entity as a result of past events where it is reasonably expected to be consumed within 12 months after the end of the reporting period.

Kevin's Keyboards

Balance Sheet (extract) as at 31 March 2025

	\$	\$
Current Assets		
Accrued Interest Revenue	200	

The Interest Revenue earned, even though it has not yet been received, by Kevin's Keyboards for the quarter ended 31 March 2025 would be reported in the Income Statement as follows.

Kevin's Keyboards
Income Statement for the quarter ended 31 March 2025

	\$	\$
Other Revenues		
Interest Revenue	200	

Effect of Interest Revenue on Accounting Equation

Element	Items Increased / Decreased	Overall Effect	Amount
Assets	Accrued Interest Revenue	Increase	\$200
Liabilities		No Effect	\$0
Owner's Equity	Net Profit (Interest Revenue)	Increase	\$200

What needs to happen on 30 June 2025?

As at 30 June 2025 three additional months of interest revenue (April / May / June) have been earned. This interest revenue is required to be included in the Income Statement for the quarter ended 30 June 2025 even though the interest will not be received until 31 July 2025.

General Journal

Date	Details	Debit	Credit
30/06	Accrued Interest Revenue	300	
	Interest Revenue		300

General Ledger (extract)

Accrued Interest Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/04	Balance	200	30/06	Balance	500
30/06	Interest Revenue	300			
		500			500
01/07	Balance	500			

Interest Revenue

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Profit and Loss Summary	300	30/06	Accrued Interest Revenue	300
		300			300

What needs to happen on 31 July 2025?

On 31 July 2025 the first of two \$600 interest payments was received.

However, just because the \$600 was received in the reporting period ended 30 September 2025 does not mean it will be treated as Interest Revenue.

The receipt of the \$600 Interest would be recorded as follows.

General Journal

Date	Details	Debit	Credit
31/07	Bank	600	
	Accrued Interest Revenue		500
	Interest Revenue		100

APPLICATION EXERCISE 19

Brent Crude owns and operates Brent's Books, a small business that applies a fixed mark-up of 150% and prepares reports on a quarterly basis.

Brent has provided the following Pre-Adjustment Trial Balance extract as at 30 June 2025.

Brent's Books

Pre

Account	Debit	Credit
<i>Term Deposit</i>	<i>25 000</i>	
<i>Unearned Rent Revenue</i>		<i>38 600</i>
<i>Unearned Sales Revenue</i>		<i>500</i>

Additional information

- On 1 December 2023 Brent's Books invested \$25 000 in a three-year Term Deposit with MNC Bank. Interest is earned at a rate of 6% per annum and is paid on a half-yearly basis on 31 May and 30 November each year.*
- Brent's Books rents out part of their premises to a Café. Rent is paid yearly in advanced. The most recent payment of \$33 600 plus GST was made on 1 May 2025 for the year ending 31 May 2026.*
- On 27 March 2025 Brent's Books received an order from Ramsey School for 75 'Culinary' books. Brent's Books sells each 'Culinary' book for \$88 including GST each. Ramsey School paid a \$500 deposit when the order was placed. On 30 June 2025 Brent's Books issued Invoice 593 to Ramsey School for the 75 'Culinary' books delivered.*

Prepare General Journal entries to record the necessary adjustments and transactions on 30 June 2025. Narrations are not

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Question 1 (6 marks)

On 1 February 2024 Robbie’s Rugs purchased a Van for \$46 200 including GST.

On the same day, Robbie’s Rugs purchased and installed roof racks and shelving for the Van for \$2 800 plus GST.

Robbie’s Rugs then paid 12-months registration for the Van for a cost of \$1 320 including GST.

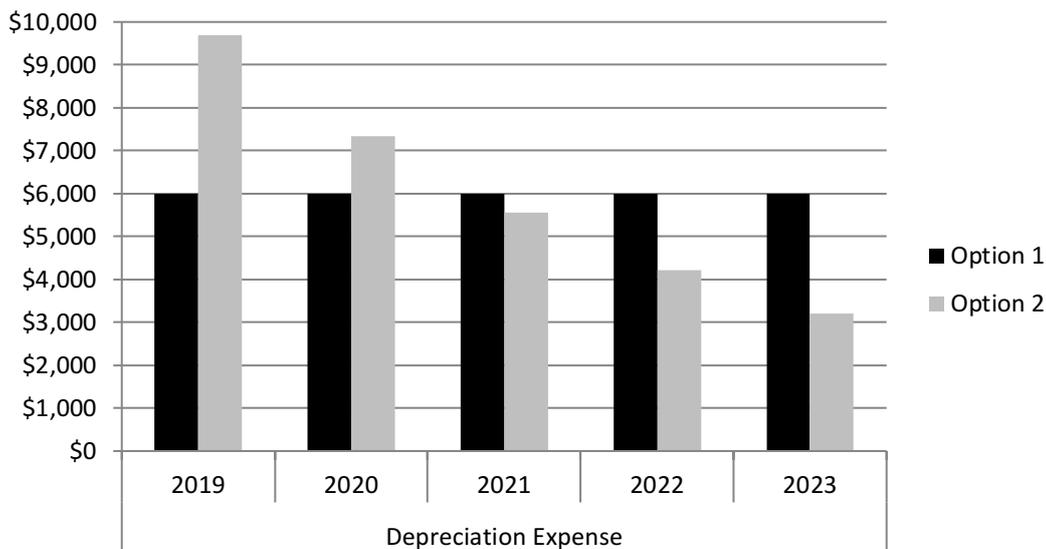
- a. Calculate the cost price of the Van to be reported on the Balance Sheet of Robbie’s Rugs as at 1 February 2025. 2 marks
- b. Referring to your answer in part a., explain your treatment of both
 - purchase and installation of the roof racks and shelving
 - 12-months registration
 in calculating the cost price of the Van. 4 marks

Question 2 (7 marks)

Alexandria Ocasio-Cortez owns and operates Alexandria’s Appliances, a small electronics business that reports annually on 30 June each year.

On 1 July 2018 the business purchased a new Van for \$44 000 including GST.

The following graph was prepared to demonstrate the Van’s annual depreciation expense over its useful life using alternative depreciation methods.



Alexandria has decided to select option 2 to depreciate the Van.

- a. State the name of the depreciation method chosen. 1 mark
- b. Justify Alexandria’s choice of using option 2. 2 marks

Alexandria believes that her business can use option 2 for the first two years of the Van’s effective life and then switch to option 1 for the final three years.

- c. Referring to one qualitative characteristic, explain why Alexandria is incorrect. 3 marks
- d. Calculate the estimated residual value of the Van at the end of its useful life. 1 mark

Question 3 (26 marks)

Clare's Chairs is a small business that applies a mark-up of 50% and prepares reports on a quarterly basis ending 31 March, 30 June, 30 September and 31 December each year.

Clare has provided the following Pre-Adjustment Trial Balance extract as at 30 June 2025.

**Clare's Chairs
Pre-Adjustment Trial Balance (extract) as at 30 June 2025**

Account	Debit	Credit
Cash Sales		7 220
Credit Sales		21 860
Prepaid Rent Expense	10 800	
Sales Returns	1 660	
Term Deposit	30 000	
Unearned Sales Revenue		2 000

Additional information at 30 June 2025

- Highland TAFE was issued with Receipt 1019 for the \$2 000 deposit they paid on 27 June 2025 for an order of 500 'Original' plastic chairs. Clare's Chairs sells each 'Original' plastic chair for \$33 including GST.
 - Wages of \$1 150 remain owing.
 - Rent is paid 6 months in advance. The most recent payment was made on 1 February for the period ended 31 August 2025.
 - On 1 August 2022 Clare's Chairs invested \$30 000 in a 3-year Term Deposit with MNC Bank earning interest at a rate of 6% per annum. Interest is paid by MNC Bank on a half-yearly basis on 31 January and 31 July each year.
- a. Explain how the deposit received from Highland TAFE would be classified in the Balance Sheet of Clare's Chairs as at 30 June 2025. 3 marks
- b. Prepare the General Journal entry to record the necessary balance day adjustment as at 30 June 2025 in relation to the Wages owing.
A narration **is** required. 2 marks
- c. Referring to one accounting assumption, explain the purpose of recording balance day adjustments. 3 marks
- d. Complete the Prepaid Rent Expense and Interest Revenue accounts in the General Ledger as at 30 June 2025. 5 marks
- On 4 July 2025 Wages of \$1 400 were paid.
- e. Explain the effect on the Accounting equation if this payment was not recorded. 3 marks
- On 31 July 2025 Clare's Chairs delivered the 500 'Original' plastic chairs to Highland TAFE and Invoice 768 was issued.
- On 31 July 2025 Clare's Chairs electronically received \$30 900 from MNC Bank.
- f. Prepare the General Journal entries to record both of these transactions.
Narrations are **not** required. 10 marks

Question 4 (11 marks)

Jordan's Jackets prepares reports on an annual basis ending 30 June each year.

On 1 January 2017 Jordan's Jackets purchased a Van for \$39 600 including GST.

The Van is expected to have a residual value of \$15 000 and an effective life of 5 years.

The Van is depreciated using the straight-line method.

On 30 June 2025 Jordan sold the Van for \$20 000.

a. Prepare the necessary General Journal entries required on 30 June 2025.

Closing entries and narrations are **not** required.

9 marks

b. With reference to your answer in part a., explain why a Profit or Loss on the sale of the Van occurred.

2 marks

END OF MINI EXAM NO. 3

Commerce Presentations & Publications
VCE PROGRAMS
Exam Preparation Lectures

Legal Studies Megan Blake	Economics Romeo Salla
Accounting Darrell Cruse	Business Mgt Matt Richardson



The lecture programs run for three and a half hours and are presented exclusively by experienced teachers who have years of experience assessing final examinations. The programs are designed to show students how to apply their knowledge of the course in the examination in a way that enhances examination performance and impresses the examiners. Each program will include:

- strategies to interpret questions accurately
- strategies to structure responses in a concise and efficient way
- analysis of sample responses
- emphasis on the common errors to avoid
- tips and tricks to employ to increase efficiency and time management
- strategies to unpack the most difficult parts of the course
- strategies to incorporate relevant and contemporary information into responses.

All participants are provided with notes to complete during the program and there will be opportunities to quiz our experienced examination assessors at the conclusion of the program.

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YOU BE THE ASSESSOR: UNIT 4 AREA OF

In this section, you are required to assess the responses presented for each of the questions. You should award the responses a score and justify your decision. Once complete, compare your assessment to that of the author provided at the CPAP website <http://www.commpap.com/page90.html>

Question 1 (2013 VCAA Exam Question 6)

A business purchased equipment on 1 January 2011 for \$24 000 plus GST. The equipment had an estimated useful life of four years and a residual value of \$3 000. The business prepares reports annually on 30 June.

Explain how the accountant should determine the appropriate method of depreciation for the equipment.

Refer to alternative methods of depreciation in your answer.

4 marks

SAMPLE ANSWER A

Depreciation is the allocation of an asset's depreciable amount as an expense over its useful life. Depreciation is an expense as it represents a decrease in Assets and a corresponding decrease in Owner's Equity (due to a decrease in Profit).

Depreciation expense needs to be included in reports in accordance with both the Accrual Basis Assumption and the Period Assumption as it is an expense incurred during the period which needs to be included so as to ensure an accurate profit.

The accountant should use the reducing balance method as the Equipment has moving parts and is likely to be more efficient in its earlier years.

Justification _____

SAMPLE ANSWER A

The accountant would determine the appropriate method of depreciation for the equipment based on the expected revenue-earning pattern of the asset.

If the Van is expected to generate the same amount of revenue each reporting period, the straight-line method should be adopted as it allocates the same amount of cost each reporting period.

However, if the Van is expected to be more productive in its earlier years and therefore generate more revenue in those periods, the reducing balance method should be adopted. The reducing balance method allocates more cost in the earlier years and less in the asset's later years, when it is less productive and therefore match the assets revenue earning pattern with the allocation of the expense.

Justification _____

Assuming the business used the reducing balance method at 30% per annum, calculate the depreciation expense for the year ended 30 June 2012.

2 marks

SAMPLE ANSWER A

$$\frac{\$24\,000 - \$3\,000}{4 \text{ years}} = \$5\,250 \text{ per year}$$

$$\$5\,250 \times 1.5 \text{ years (18 months)} = \underline{\underline{\$7\,875}}$$

Justification _____

SAMPLE ANSWER B

$$(\$24\,000 - \$3\,000) \times 30\% = \underline{\underline{\$6\,300}}$$

Justification _____

Calculate what the carrying value of the equipment would have been at 30 June 2013 if the straight line method of depreciation had been used each year.

2 marks

SAMPLE ANSWER A

$$\frac{\$24\,000 - \$3\,000}{4} = \$5\,250 \text{ per year}$$

1 January 2011 to 30 June 2013 = 2 ½ years or 30 months

$$\$5\,250 \times 2.5 = \$13\,125$$

Justification _____

SAMPLE ANSWER B

$$\frac{\$24\,000 - \$3\,000}{4} = \$5\,250 \text{ per year}$$

1 January 2011 to 30 June 2013 = 2 ½ years or 30 months

$$\$5\,250 \times 2.5 = \$13\,125$$

$$\$24\,000 - \$13\,125 = \underline{\underline{\$10\,875}}$$

Justification _____

Question 2 (2017 VCAA June Exam Question 5)

Candy Enterprises sells chocolates and lollies. It reports on an annual basis on 30 June each year.

On 1 June 2015, Candy Enterprises purchased three mobile phones for the use of the sales staff.

Each mobile phone cost \$900 (plus GST) and was bought on credit from DigPhones. The mobile phones were depreciated at 40% per annum using the reducing balance method. The business decided to dispose of the mobile phones on 30 June 2016 and received \$400 cash for each phone.

Show how the following accounts would appear in the General Ledger after all details of the purchase and sale of the mobile phones have been posted:

- **Mobile Phones**
- **Accumulated Depreciation of Mobile Phones**
- **Disposal of Mobile Phones**

You are not required to balance the accounts.

7 marks

SAMPLE ANSWER A

Mobile Phones

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/06	Balance	900	30/06	Disposal of Mobile Phones	900

Accumulated Depreciation of Mobile Phones

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Disposal of Mobile Phones	390	30/06	Depreciation – Mobile Phones	390
		390			390

Disposal of Mobile Phones

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Mobile Phones	900	30/06	Accumulated Depreciation – Mobile Phones	390
				Bank	400
				Loss on Disposal – Mobile Phones	110
		900			900

Justification _____

SAMPLE ANSWER B

Mobile Phones

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/07	Balance	2 700	30/06	Disposal of Mobile Phones	2 700

Accumulated Depreciation of Mobile Phones

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Disposal of Mobile Phones	1 134	30/06	Depreciation – Mobile Phones	1 134
		1 134			1 134

Disposal of Mobile Phones

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/06	Mobile Phones	2 700	30/06	Accumulated Depreciation	1 134
				Bank	1 200
				Loss on Disposal	366
		2 700			2 700

Justification _____

Question 3 (2018 VCAA November Exam Question 7)

Katy's Cakes sells made-to-order cakes. The business reports monthly.

On 15 September 2018, the business paid \$2 400 plus GST for a three-month social media advertising campaign that commenced on 1 September 2018.

The balance of the Prepaid Advertising at 30 September 2018 is \$1 900.

Complete the Prepaid Advertising and Advertising Expense accounts at 30 September 2018.

You are required to balance or close the accounts, as appropriate.

5 marks

SAMPLE ANSWER A

Prepaid Advertising

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/09	Balance	3 800	30/09	Advertising Expense	9 100
30/09	Bank	7 200		Balance	1 900
		11 000			11 000
01/10	Balance	1 900			

Advertising Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/09	Prepaid Advertising	9 100	30/09	Profit and Loss Summary	9 100
		9 100			9 100

Justification _____

SAMPLE ANSWER B**Prepaid Advertising**

Date	Cross-reference	Amount	Date	Cross-reference	Amount
01/09	Balance	3 800	30/09	Advertising Expense	4 300
30/09	Bank	2 400		Balance	1 900
		6 200			6 200
01/10	Balance	1 900			

Advertising Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
30/09	Prepaid Advertising	4 300	30/09	Profit and Loss Summary	4 300
		4 300			4 300

Justification _____

_____**Question 4 (2017 VCAA November Exam Question 5)**

CLU Lipsticks is a small business that sells quality lipsticks. Reports are prepared annually on 30 June. The accountant has provided the following extract from a Pre-adjustment Trial Balance as at 30 June 2017.

**CLU Lipsticks
Pre-adjustment Trial Balance (extract) as at 30 June 2017**

Account	Debit	Credit
Accounts Receivable	14 620	
Accumulated Depreciation - Vehicle		5 634
Advertising	3 900	
Bank Term Deposit (matures 30 June 2020)	12 000	
Cash at Bank	18 400	
Cost of Sales	78 000	
Discount Expense	980	
Drawings	45 000	
GST Clearing		6 930
Interest Expense	1 700	
Inventory	22 400	
Loan – BLD Bank		24 000

Prepaid Rent Expense	3 900	
Sales		171 600
Vehicle	44 134	
Wages	41 800	

Additional information at 30 June

- The vehicle is depreciated at a rate of 25% per annum using the reducing balance method. The vehicle has a useful life of four years and an expected residual value of \$4 000.
- Interest on the Bank Term Deposit is 6% per annum and is received annually. The term deposit was established on 1 October 2016.
- A payment for Wages of \$280 was incorrectly recorded as a payment for Drawings.
- The owner donated \$160 of inventory to the local kindergarten for its annual fundraiser. The owner had not recognised this entry when conducting the inventory count.
- The inventory count showed \$21 860 of inventory on hand.

Record the additional information in the General Journal provided. Narrations are not required.

10 marks

SAMPLE ANSWER A

General Journal

Date	Details	Debit	Credit
30/06	Depreciation – Vehicle	11 034	
	Accumulated Depreciation - Vehicle		11 034
	Accrued Interest Revenue	720	
	Interest Revenue		720
	Drawings	280	
	Wages		280
	Drawings	160	
	Inventory		160
	Inventory Loss	540	
	Inventory		540

Justification _____

SAMPLE ANSWER B

General Journal

Date	Details	Debit	Credit
30/06	Depreciation	9 625	
	Accumulated Depreciation		9 625
	Accrued Interest Revenue	540	
	Interest Revenue		540
	Wages	280	
	Drawings		280
	Advertising	160	
	Inventory		160
	Inventory Loss	380	
	Inventory		380

Justification _____

Question 5 (2016 VCAA Exam Question 4)

MixM Games sell electronic games. The business prepares reports every six months, in June and December.

Pre-adjustment Trial Balance (extract) as at 30 June 2016

	Debit	Credit
Sales		210 000
Unearned Sales Revenue		4 100
Wages	67 000	
Advertising Expense	45 000	
Cost of Sales	105 000	
Cartage In	3 200	
Delivery Expense	560	
Discount Revenue		340
Sales Returns	1 340	

Loan		7 200
Inventory	35 000	

Additional information

- Wages of \$2 300 are owing at 30 June.
- The loan (interest only) was taken out on 1 February 2016 at 8% per annum. No interest has been paid to date.
- Vehicles costing \$120 000 (plus GST) were purchased on 1 June 2015. They have an estimated useful life of eight years and an estimated residual value of \$24 750. The vehicles are depreciated at a rate of 20% per annum using the reducing balance method.

Prepare the Income Statement for the six months ended 30 June 2016.

7 marks

SAMPLE ANSWER A

MixM Games

Income Statement for the six months ending 30 June 2016

	\$	\$
Revenues		
Sales		210 000
Less: Cost of Goods Sold		
Cost of Sales	105 000	
Cartage Inwards	3 200	
Delivery Expense	560	108 760
Gross Profit		101 240
Plus: Other Revenues		
Discount Revenue		340
Less: Other Expenses		
Advertising	45 000	
Depreciation - Vehicles	12 000	
Interest Expense	288	
Wages	67 000	124 288
Net Profit / (Loss)		(22 708)

Justification _____

SAMPLE ANSWER B

MixM Games

Income Statement for the six months ending 30 June 2016

	\$	\$
Revenues		
Sales	210 000	
Less: Sales Returns	1 340	208 660
Less: Cost of Goods Sold		
Cost of Sales	105 000	
Cartage Inwards	3 200	108 200
Gross Profit		100 460
Plus: Other Revenues		
Discount Revenue		340
		100 800
Less: Other Expenses		
Advertising	45 000	
Delivery Expense	560	
Depreciation - Vehicles	10 620	
Interest Expense	240	
Wages	69 300	125 720
Net Profit / (Loss)		(24 920)

Justification _____

UNIT 4: RECORDING, REPORTING, BUDGETING AND DECISION

Area of Study 2

Business owners must plan for future activities if they are to successfully manage the business. Preparing budgeted accounting reports provides the owner with information that will assist in managing and developing strategies to improve business performance. Students prepare and analyse budgeted accounting reports, both manually and using ICT, and suggest strategies to improve the performance of the business. They also discuss and evaluate the ethical considerations associated with business decision-making and business improvement.

Outcome 2

On completion of this unit, the student should be able to prepare budgeted accounting reports and variance reports for a trading business, using financial and other relevant information, and model, analyse and discuss the effects of alternative strategies on the performance of a business.

To achieve this outcome, the student will draw on key knowledge and key skills outlined in Area of Study 2.

Key knowledge

- the accounting assumptions and qualitative characteristics
- indicators and other relevant information (financial and non-financial) used to measure business performance
- the characteristics and use of classified budgeted accounting reports:
 - Budgeted Cash Flow Statement
 - Budgeted Income Statement
 - Budgeted Balance Sheet
- the use of variance reports and trends for Cash Flow Statements and Income Statements
- the distinction between cash and profit
- the analysis of historical and budgeted accounting reports, including a consideration of the limitations of analysis, to develop strategies to improve business performance
- graphical representations related to preparing and interpreting budgeted accounting reports
- strategies to improve business performance
- ethical considerations in relation to business decision-making and the strategies used to improve business performance

Key skills

- use applicable accounting terminology
- explain and apply relevant qualitative characteristics and accounting assumptions
- apply theoretical knowledge to simulated situations
- manually prepare classified budgeted accounting reports and variance reports
- use ICT, including spreadsheets, to prepare and analyse classified budgeted accounting reports and variance reports, and construct graphical representations
- model and analyse the financial effects of alternative strategies to improve business performance
- analyse and interpret classified historical, budgeted and variance reports, graphical representations and other information to evaluate the performance of a business
- discuss strategies to improve the performance of a business
- discuss and evaluate ethical considerations in relation to business decision-making and the strategies used to improve business performance

Budgeting

A sole proprietor operating a trading business may not have the expertise or the time to participate in the budgeting process. Although, one responsibility of a business owner is to plan for the future.

Planning and budgeting are not the same.

Planning involves setting goals and outlining ways of achieving them. On the other hand, a budget sets out goals in financial terms. A budget's maximum length is usually 12 months, whereas planning can be for a much longer period of time such as five years. A budget focuses on short-term goals such as sales and profit targets, whereas planning considers economic trends, the political environment and strategies the business will use to achieve long-term goals.

The VCE Accounting requires students to prepare budgeted financial reports. Students use a combination of historical data and predictions to prepare a Budgeted Cash Flow Statement, a Budgeted Income Statement and a Budgeted Balance Sheet.

Exam Tip: The annual budgeting process is commonly focused on producing a fixed budget for the following 12-month period. However, a budget period is not necessarily one year in length. Past exams have required students to prepare a Budgeted Income Statement for periods less than a year, such as a Budget for one month, or a six-month Budget. Misreading the question can therefore be quite costly in the examination.

Once the budget has been finalised it becomes an important basis for evaluating performance. A benefit to a business owner of the budgeting process is that it aids in the control of the business in achieving its set goals. Such control occurs when the actual results are compared with the budget reports. This enables the business owner to identify variances between the actual and the budget, investigate their causes and take the necessary corrective action. Further to this, the business can then modify their future plans.

Exam Tip: A past exam required students to explain how budgeting improves control within a business. Students were required to explain that employees can be held responsible for unfavourable variances and future expenditure limited and therefore controlled in accordance with agreed upon targets.

VCE Accounting students are most commonly faced with a scenario of having to 'reconstruct' a General Ledger account in order to calculate a missing amount. For instance, students can be required to reconstruct the Accounts Receivable account in order to calculate the Budgeted Receipts from Accounts Receivable. The ledger templates on the following page are the most common ones used in assessing students' budgeting skills.

Exam Tip: As outlined previously, a useful way to prepare for assessment tasks and exams is to create study cards for specific General Ledger accounts. This is particularly useful in the budgeting reconstruction process. Study cards should be created for the Accounts Receivable, Inventory, Accounts Payable, Prepaid Expenses, Accrued Expenses and Capital ledgers. Even if there are not enough lines provided in the Answer Book, write out the entire template. This will provide you with a checklist of items to look for in the information provided in the question. Students are not penalised in Accounting for writing outside a template provided. There is no requirement to use Dates or to formally balance an account in the reconstruction process.

Alison's Appliances will be the business case study used for the budgeting section of Unit 4 Area of Study 2.

Calculating Budgeted Receipts from Accounts Receivable Template

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance			Bank	
	Credit Sales			Discount Expense	
	GST Clearing			Allowance for Doubtful Debts	
				GST Clearing	
				Sales Returns	
				GST Clearing	
				Closing Balance	

Calculating Budgeted Payments to Accounts Payable Template

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance			Cost of Sales	
	Bank			Advertising	
	Accounts Payable			Drawings	
	Cost of Sales (Sales Return)			Inventory Loss	
				Inventory Write Down	
				Accounts Payable (Purchase Return)	
				Closing Balance	

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Bank			Opening Balance	
	Discount Revenue			Inventory	
	Inventory (Purchase Return)			GST Clearing	
	GST Clearing				
	Closing Balance				

Alison's Appliances

Alison Wonderland owns and operates Alison's Appliances, a small business that prepares reports on an annual basis. Alison has employed you to complete the budgeting process for the year ended 30 June 2026. Her accountant has provided the following Balance Sheets.

Alison's Appliances Balance Sheet	Actual 30 June 2025	Budgeted 30 June 2026
Current Assets		
Cash at Bank	15 120	3 030
Accounts Receivable	29 300	35 000
Less: Allowance for Doubtful Debts	(3 800)	(8 960)
Inventory	23 500	30 000
Prepaid Rent Expense	18 000	20 000
	82 120	79 070
Non-Current Assets		
Equipment	14 000	24 000
Less: Accumulated Depreciation	(4 200)	(7 550)
Van	36 000	42 000
Less: Accumulated Depreciation	(18 360)	(2 100)
	27 440	56 350
Total Assets	109 560	135 420
Current Liabilities		
Accounts Payable	16 500	13 200
Accrued Wages	-	1 800
GST Clearing	1 690	1 300
Loan – CCA Bank	8 000	8 000
	26 190	24 300
Non-Current Liabilities		
Loan – CCA Bank	16 000	38 000
Owner's Equity		
Capital	84 650	67 370
Plus: Net Profit	14 320	25 750
Less: Drawings	31 600	20 000
	67 370	73 120
Total Equities	109 560	135 420

Alison has asked you to use the following information to complete the budgeting process for the year ended 30 June 2026.

- Total Sales \$600 000 plus GST
 - Credit Sales 70% of Total Sales
 - Mark-Up 50%
 - Sales Returns \$13 200 including GST
 - Purchase Returns \$8 000 plus GST
 - Bad Debts Written Off \$3 300 including GST
 - Doubtful Debts 2% of Net Credit Sales
 - Discount Expense \$5 000
 - Inventory Purchases 80% on Credit
 - Inventory Loss \$6 000
 - Advertising Expense \$20 000 plus GST (includes \$2 500 of Inventory)
 - Discount Revenue \$9 000
 - Freight Inwards \$15 000 plus GST
 - All non-current assets are sold and purchased using cash
 - Proceeds from Disposal of Van \$12 000
 - Depreciation Expense – Van \$6 510
 - Equipment \$10 000 plus GST purchase on 1 September 2025
 - Equipment depreciated using straight-line (15% p.a.)
 - Quarterly Loan Repayments \$3 000 including \$1 000 interest
 - General Expenses \$25 000 plus GST
 - Prepaid Rent Expense \$48 000 plus GST paid in November 2025 for the year ended 30 November 2026
 - Wages Expense \$3 250 per month
 - GST Paid \$24 050
 - GST Settlements \$2 440
 - All transactions between Alison and the business involve cash
- a. Reconstruct the Accounts Receivable ledger in order to calculate budgeted Receipts from Accounts Receivable for the year ended 30 June 2026.
 - b. Reconstruct the Inventory and Accounts Payable ledgers in order to calculate budgeted Payments to Accounts Payable for the year ended 30 June 2026.
 - c. Prepare the Budgeted Cash Flow Statement for the year ended 30 June 2026.
 - d. Prepare the Budgeted Income Statement for the year ended 30 June 2026.

Exam Tip: This is a comprehensive example. Historically, exam questions have avoided the complication of Sales Returns and Purchase Returns in the account reconstruction process. The trend in recent exams is to provide students with a list of data similar to that of Alison's Appliances above and require students to complete either a Budgeted Cash Flow Statement or a Budgeted Income Statement. Even though this is a rather simplistic task with minimal areas of concern for the prepared student, the format of the reports, particularly the Cash Flow Statements, remains problematic.

Calculating Budgeted Receipts from Accounts Receivable

Step 1: Write out the Accounts Receivable template

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance			Bank	
	Credit Sales			Discount Expense	
	GST Clearing			Allowance for Doubtful Debts	
				GST Clearing	
				Sales Returns	
				GST Clearing	
				Closing Balance	

Exam Tip: Students should split the Sales between Cash and Credit as per the percentages provided in the question. Further to this, the Credit Sales and GST Clearing amounts should also be separated as Discount Expense, Allowance for Doubtful Debts and Sales Returns amounts are often expressed as a percentage of Credit Sales, not Credit Sales including GST. If the amount of Credit Sales and GST Clearing are combined as they would be in a normal General Ledger entry, the possibility of an incorrect calculation arises.

Step 2: Complete and total the Debit side of the Accounts Receivable template

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance	29 300		Bank	
	Credit Sales	420 000		Discount Expense	
	GST Clearing	42 000		Allowance for Doubtful Debts	
				GST Clearing	
				Sales Returns	
				GST Clearing	
				Closing Balance	
		491 300			

Step 3: Transfer the total of the Debit side to the Credit side of the Accounts Receivable template

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance	29 300		Bank	
	Credit Sales	420 000		Discount Expense	
	GST Clearing	42 000		Allowance for Doubtful Debts	
				GST Clearing	
				Sales Returns	
				GST Clearing	
				Closing Balance	
		491 300			491 300

Step 3: Complete the remaining entries (except Bank) on the Credit side of the Accounts Receivable template.

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance	29 300		Bank	?
	Credit Sales	420 000		Discount Expense	5 000
	GST Clearing	42 000		Allowance for Doubtful Debts	3 000
				GST Clearing	300
				Sales Returns	12 000
				GST Clearing	1 200
				Closing Balance	35 000
		491 300			491 300

Exam Tip: Students need to pay particular attention to the difference between recording an increase in the Allowance for Doubtful Debts and writing off of bad debt. The 2017 VCAA exam introduced the concept of 'Net Sales', being Sales less Sales Returns from the Income Statement. Therefore, 'Net Credit Sales' is Credit Sales less Sales Returns from the Income Statement. A reminder that to record a Doubtful Debt, a debit entry is made to the Bad Debt expense account and a credit entry to the Allowance for Doubtful Debts account. Whereas, to write off a bad debt, debit entries are made to both the Allowance for Doubtful Debts and GST Clearing accounts with a corresponding credit entry made to Accounts Receivable. An incorrect treatment would be to credit Accounts Receivable with the amount of the Doubtful Debt $[(\$420\,000 - \$12\,000) \times 2\% = \$8\,160]$ rather than the amount of the budgeted Bad Debt to be written off (\$3 000).

Step 4: Calculate the amount to be recorded in the Bank entry to make the Credit side of the Accounts Receivable template equal the total transferred from the Debit side.

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance	29 300		Bank	434 800
	Credit Sales	420 000		Discount Expense	5 000
	GST Clearing	42 000		Allowance for Doubtful Debts	3 000
				GST Clearing	300
				Sales Returns	12 000
				GST Clearing	1 200
				Closing Balance	35 000
		491 300			491 300

Once the Accounts Receivable template has been completed and the budgeted Receipts from Accounts Receivable amount calculated, a number of entries can be made into the Budgeted Income Statement and the Budgeted Cash Flow Statement.

The Budgeted Income Statement in the Answer Booklet could be completed as follows.

Alison's Appliances

Budgeted Income Statement for the year ending 30 June 2026

	\$	\$
Revenues		
Cash Sales	180 000	
Credit Sales	420 000	
Less: Sales Returns	12 000	588 000

There could also be a Discount Expense entry of \$5 000 under the heading 'Other Expenses' towards the bottom half of the Answer Booklet.

The Budgeted Cash Flow Statement in the Answer Booklet could be completed as follows.

Alison's Appliances

Budgeted Cash Flow Statement for the year ending 30 June 2026

	\$	\$
Cash Flow from Operating Activities		
Cash Sales	180 000	
GST Collected	18 000	
Receipts from Accounts Receivable	434 800	

The Cash Sales amount is calculated by deducting Credit Sales from Total Sales.

Calculating Budgeted Payments to Accounts Payable

Step 1: Write out the Inventory and Accounts Payable templates

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance			Cost of Sales	
	Bank			Advertising	
	Accounts Payable			Drawings	
	Cost of Sales			Inventory Loss	
				Inventory Write Down	
				Accounts Payable	
				Closing Balance	

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Bank			Opening Balance	
	Discount Revenue			Inventory	
	Inventory			GST Clearing	
	GST Clearing				
	Closing Balance				

Step 2: Complete and total the Credit side of the Inventory template

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance			Cost of Sales	400 000
	Bank			Advertising	2 500
	Accounts Payable			Drawings	0
	Cost of Sales			Inventory Loss	6 000
				Inventory Write Down	0
				Accounts Payable	8 000
				Closing Balance	30 000
					446 500

Exam Tip: The main issue with the Inventory template is the calculation of the Cost of Sales amount. Once again, it is the reading of the question that is crucial. The Cost of Sales amount is not 50% of the Total Sales, but rather the application of a 50% mark-up to the Total Sales ($\$600\,000 / 1.5$). A second issue surrounds the use of Inventory as Drawings or for Advertising purposes. Students need to look for the words 'including' or 'plus' when recording transactions involving Advertising and Drawings as part of the budgeted amount may involve a portion of Inventory. This not only has an impact on the reconstruction of the Inventory account, but the amount of Drawings and Advertising in the Budgeted Cash Flow Statement.

Step 3: Transfer the total of the Credit side to the Debit side of the Inventory template

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance			Cost of Sales	400 000
	Bank			Advertising	2 500
	Accounts Payable			Drawings	0
	Cost of Sales			Inventory Loss	6 000
				Inventory Write Down	0
				Accounts Payable	8 000
				Closing Balance	30 000
		446 500			446 500

Step 4: Calculate the Total Purchases and apply the Credit Purchases % and Cash Purchases %

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance	23 500		Cost of Sales	400 000
	Bank	?		Advertising	2 500
	Accounts Payable	?		Drawings	0
	Cost of Sales	8 000		Inventory Loss	6 000
				Inventory Write Down	0
				Accounts Payable	8 000
				Closing Balance	30 000
		446 500			446 500

Exam Tip: This is the most difficult aspect of the Inventory template reconstruction. In order to calculate the Total Purchases amount, the total of the Debit side is deducted from the Cost of Sales entry from the Sales Returns and the Opening Balance (\$446 500 - \$8 000 - \$23 500 = \$415 000). This Total Purchases amount could even be written above the Cross-reference title on the Debit side of the Inventory template.

Step 5: Apply the Credit Purchases % and Cash Purchases % to Total Purchases

		Inventory			
Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance	23 500		Cost of Sales	400 000
	Bank	83 000		Advertising	2 500
	Accounts Payable	332 000		Drawings	0
	Cost of Sales	8 000		Inventory Loss	6 000
				Inventory Write Down	0
				Accounts Payable	8 000
				Closing Balance	30 000
		446 500			446 500

Total Purchases x 80% on Credit = \$332 000 credit purchases of Inventory.

Therefore, Total Purchases x 20% on Cash = \$83 000 cash purchases of Inventory.

Exam Tip: Before moving on to the Accounts Payable template, students should quickly calculate that the total of the Debit side now equals the amount transferred from the Credit side of the Inventory template. Alternatively, students should quickly calculate that the Bank and Accounts Payable entries equal the Total Purchases amount.

Step 6: Complete and total the Credit side of the Accounts Payable template

		Inventory			
Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Opening Balance	23 500		Cost of Sales	400 000
	Bank	83 000		Advertising	2 500
	Accounts Payable	332 000		Drawings	0
	Cost of Sales	8 000		Inventory Loss	6 000
				Inventory Write Down	0
				Accounts Payable	8 000
				Closing Balance	30 000
		446 500			446 500

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Bank			Opening Balance	16 500
	Discount Revenue			Inventory	332 000
	Inventory			GST Clearing	33 200
	GST Clearing				
	Closing Balance				
					381 700

Exam Tip: As the Inventory template reconstruction process calculated the credit purchases of Inventory amount, it then needs to be transferred to the Accounts Payable template. An additional requirement is for the GST to be added to the credit purchases of Inventory amount.

Step 7: Transfer the total of the Credit side to the Debit side of the Accounts Payable template

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Bank			Opening Balance	16 500
	Discount Revenue			Inventory	332 000
	Inventory			GST Clearing	33 200
	GST Clearing				
	Closing Balance				
		381 700			381 700

Step 8: Complete the remaining entries (except Bank) on the Debit side of the Accounts Payable template.

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Bank	?		Opening Balance	16 500
	Discount Revenue	9 000		Inventory	332 000
	Inventory	8 000		GST Clearing	33 200
	GST Clearing	800			
	Closing Balance	13 200			
		381 700			381 700

Completing Budgeted Income Statement from Template Reconstructions

Based on the three main template reconstructions, the following example illustrates just how much of the Budgeted Income Statement and Budgeted Cash Flow Statement can be completed by using the amounts from the templates.

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Balance	29 300		Bank	434 800
	Credit Sales	420 000		Discount Expense	5 000
	GST Clearing	42 000		Allowance for Doubtful Debts	3 000
				GST Clearing	300
				Sales Returns	12 000
				GST Clearing	1 200
				Balance	35 000
		491 300			491 300

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Balance	23 500		Cost of Sales	400 000
	Bank	83 000		Advertising	2 500
	Accounts Payable	332 000		Drawings	0
	Cost of Sales	8 000		Inventory Loss	6 000
				Inventory Write Down	0
				Accounts Payable	8 000
				Balance	30 000
		446 500			446 500

Accounts Payable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Bank	350 700		Balance	16 500
	Discount Revenue	9 000		Inventory	332 000
	Inventory	8 000		GST Clearing	33 200
	GST Clearing	800			
	Balance	13 200			
		381 700			381 700

Alison's Appliances
Budgeted Income Statement for the year ending 30 June 2026

	\$	\$
Revenues		
Cash Sales	180 000	
Credit Sales	420 000	
Less: Sales Returns	12 000	588 000
Less: Cost of Goods Sold		
Cost of Sales	392 000	
Freight Inwards	15 000	407 000
Gross Profit		181 000
Less: Inventory Loss		6 000
Adjusted Gross Profit		175 000
Add: Other Revenues		
Discount Revenue		9 000
		184 000
Less: Other Expenses		
Discount Expense	5 000	

Alison's Appliances
Budgeted Cash Flow Statement for the year ending 30 June 2026

	\$	\$
Cash Flow from Operating Activities		
Receipts from Accounts Receivable	434 800	
Payments to Accounts Payable	(350 700)	
Purchases of Inventory	(83 000)	

Exam Tip: The purpose of this exercise is to demonstrate the concept of 'consequential errors'. Regardless of the amounts students enter in their template reconstructions for Accounts Receivable, Inventory and Accounts Payable, if these amounts are then transferred correctly into the Budgeted Income Statement and Budgeted Cash Flow Statement students are awarded the marks and are not penalised again.

Exam Tip: Due to the inclusion of Sales Returns in the Budgeted Income Statement, the Cost of Sales is not just the credit entry in the Inventory template reconstruction. This amount needs to be 'netted off' against the Cost of Sales debit entry in the Inventory template being the Cost of Sales from the Sales Return.

The Budgeted Cash Flow Statement reports the estimated cash receipts and estimated cash payments for the budgeted period. This enables an estimated cash balance at the end of the budgeted period to be calculated.

Alison's Appliances

Below is a series of suggested steps to be followed and issues to be considered when completing the Budgeted Cash Flow Statement for Alison's Appliances for the year ended 30 June 2026.

Step 1: Bank Balances

Alison's Appliances Balance Sheet	Actual 30 June 2025	Budgeted 30 June 2026
Current Assets		
Cash at Bank	15 120	3 030

Alison's Appliances Budgeted Cash Flow Statement (extract) for the year ending 30 June 2026

	\$	\$
Bank Balance at 1 July 2025		15 120
Bank Balance at 30 June 2026		3 030

Exam Tip: When students are given the budgeted Bank balance and are asked to complete the Budgeted Cash Flow Statement, the final three lines can be completed before anything else. The change in the Bank balances between the actual and the budgeted will represent the Net Increase / (Decrease) in Cash Position.

Alison's Appliances Budgeted Cash Flow Statement (extract) for the year ending 30 June 2026

Net Increase / (Decrease) in Cash Position		(12 090)
Bank Balance at 1 July 2025		15 120
Bank Balance at 30 June 2026		3 030

Exam Tip: Students need to be reminded again of the importance of knowing templates. Past exams required students to prepare a Budgeted Cash Flow Statement. However, the Answer Booklet provided students with no favours as no headings provided. This caused students many issues, including not knowing how many lines the Operating Activities should have. A recommendation would be for students to practice writing out the headings for a Cash Flow Statement from the bottom to the top. The final four lines of a Cash Flow Statement will always be the same. Students should write those in the Answer Booklet, leave four blank lines for Financing Activities and three blank lines for Investing Activities. The blank lines, together with the standard headings and subtotals, will provide students with enough lines to complete the Operating Activities section. Even if lines are left blank, students will not be penalised.

Step 2: Cash Sales

This is a seemingly straight forward calculation. As Total Sales are expected to be \$600 000 and Credit Sales are expected to be 70% of Total Sales, therefore Cash Sales will be the remaining 30%.

Alison's Appliances

Budgeted Cash Flow Statement (extract) for the year ending 30 June 2026

	\$	\$
Cash Flow from Operating Activities		
Cash Sales	180 000	
GST Collected	18 000	

Exam Tip: Two common errors occur as a result of calculating the correct Cash Sales amount. The first is that students do not realise that GST will be collected when a Cash Sale is made. The second is that students include the GST from the Total Sales amount and not just the 10% of the Cash Sales.

Step 3: Remaining Movements of Cash

The next obvious step would be to identify all remaining movements of cash from the information provided in the question and classify them appropriately in the Budgeted Cash Flow Statement.

- Advertising Expense \$20 000 plus GST (**includes** \$2 500 of Inventory)
- Discount Revenue \$9 000
- Freight Inwards \$15 000 plus GST
- All non-current assets are sold and purchased using cash
- Proceeds from Disposal of Van \$12 000
- Depreciation Expense – Van \$6 510
- Equipment \$10 000 plus GST purchase on 1 September 2019
- Equipment depreciated using straight-line (15% p.a.)
- Quarterly Loan Repayments \$3 000 **including** \$1 000 interest
- General Expenses \$25 000 plus GST
- Prepaid Rent Expense \$48 000 plus GST paid in November 2019 for the year ended 30 November 2020
- Wages Expense \$3 250 per month
- GST Paid \$24 050
- GST Settlements \$2 440
- All transactions between Alison and the business involve cash

Exam Tip: Students need to look for the words 'includes' or 'including' during reading time. From a cash flow point of view, Advertising paid does not include the \$2 500 of Inventory component. The same issue applies to the loan repayments. Each quarterly loan repayment of \$3 000 includes \$1 000 of interest. However, a further complication for students is the requirement to multiply these amounts by four to 'annualise' them for inclusion in the annual budgeted reports.

Step 4: Reconstruct any remaining accounts when an Opening and Closing balance is provided

An important point to note at this stage of the budgeting process is that some of the Budgeted Cash Flow Statement and some of the Budgeted Income Statement have been completed by looking at the template reconstructions and the information provided in the question.

Each of the accounts from the Balance Sheets, with the exception of Cash at Bank, Accounts Receivable, Inventory, Accounts Payable and GST Clearing, now require individual attention.

Alison's Appliances Balance Sheet	Actual 30 June 2025	Budgeted 30 June 2026
Current Assets		
Cash at Bank	15 120	3 030
Accounts Receivable	29 300	35 000
Less: Allowance for Doubtful Debts	(3 800)	(8 960)
Inventory	23 500	30 000
Prepaid Rent Expense	18 000	20 000
Non-Current Assets		
Equipment	14 000	24 000
Less: Accumulated Depreciation	(4 200)	(7 550)
Van	36 000	42 000
Less: Accumulated Depreciation	(18 360)	(2 100)
Current Liabilities		
Accounts Payable	16 500	13 200
Accrued Wages	-	1 800
GST Clearing	1 600	1 300
Loan – CCA Bank	8 000	8 000
Non-Current Liabilities		
Loan – CCA Bank	16 000	38 000
Owner's Equity		
Capital	84 650	67 370
Plus: Net Profit	14 320	25 750
Less: Drawings	31 600	20 000

Exam Tip: Whenever students are given an opening balance and a closing balance of an account, they should use the Answer Booklet to unofficially reconstruct the account. Using the information provided from the question, students would be able to complete three out of the four balances of an account. For example, the reconstruction of a Prepaid Expense account will enable students to calculate either the Prepaid Expense paid or the expense incurred. Similarly, the reconstruction of an Accrued Expense account will enable students to calculate the expense paid or the expense incurred.

The following are suggested approaches to difficult concepts in budgeting questions.

Allowance for Doubtful Debts

In order to calculate the amount of Doubtful Debts to be included in the Budgeted Income Statement, a relatively simple calculation needs to be made.

(Credit Sales – Sales Returns) x 2% = Doubtful Debts Expense

(\$420 000 - \$12 000) x 2% = **\$8 160**

An alternative approach would be to reconstruct the Allowance for Doubtful Debts template to determine the Bad Debts expense amount.

Alison’s Appliances Balance Sheet (extract)	Actual 30 June 2025	Budgeted 30 June 2026
Current Assets		
Less: Allowance for Doubtful Debts	(3 800)	(8 960)

- Bad Debts Written Off \$3 300 including GST

Allowance for Doubtful Debts

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Accounts Receivable	3 000		Balance	3 800
	Balance	8 960		Bad Debts	?
		11 960			11 960

Allowance for Doubtful Debts

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Accounts Receivable	3 000		Balance	3 800
	Balance	8 960		Bad Debts	8 160
		11 960			11 960

As three out of the four amounts have been provided for the Allowance for Doubtful Debts account, the Doubtful Debts entry of \$8 160 is able to be calculated.

**Alison’s Appliances
Budgeted Income Statement (extract) for the year ending 30 June 2026**

	\$	\$
Less: Other Expenses		
Bad Debts	8 160	

Prepaid Rent Expense

Alison’s Appliances Balance Sheet (extract)	Actual 30 June 2025	Budgeted 30 June 2026
Current Assets		
Prepaid Rent Expense	18 000	20 000

- Prepaid Rent Expense \$48 000 plus GST paid in November 2025 for the year ended 30 November 2026

Prepaid Rent Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Balance	18 000		Rent Expense	?
	Bank	48 000		Balance	20 000
		66 000			66 000

Prepaid Rent Expense

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Balance	18 000		Rent Expense	46 000
	Bank	48 000		Balance	20 000
		66 000			66 000

**Alison's Appliances
Budgeted Cash Flow Statement for the year ending 30 June 2026**

	\$	\$
Cash Flow from Operating Activities		
Prepaid Rent Expense	(48 000)	

**Alison's Appliances
Budgeted Income Statement (extract) for the year ending 30 June 2026**

	\$	\$
Less: Other Expenses		
Rent Expense	46 000	

Equipment

Alison's Appliances Balance Sheet (extract)	Actual 30 June 2025	Budgeted 30 June 2026
Non-Current Assets		
Equipment	14 000	24 000
Less: Accumulated Depreciation	(4 200)	(7 550)

- All non-current assets are sold and purchased using cash
- Equipment \$10 000 plus GST purchase on 1 September 2025
- Equipment depreciated using straight-line (15% p.a.)

In order to calculate the Depreciation Expense for the Equipment, students need to realise that additional Equipment was purchased on 1 September 2025 and is therefore only owned for 10 months of the budgeted period.

Existing Equipment

\$14 000 x 15% = \$2 100 per annum

New Equipment

\$10 000 x 15% = \$1 500 per annum

$\frac{\$1\,500}{12} = \125 per month

\$125 per month x 10 months = \$1 250

Depreciation Expense = \$3 350 (\$2 100 + \$1 250)

Alison's Appliances

Budgeted Income Statement (extract) for the year ending 30 June 2026

	\$	\$
Less: Other Expenses		
Depreciation - Equipment	3 350	

Exam Tip: As the \$10 000 increase in the Equipment is equal to the \$10 000 Equipment purchase, the \$3 350 increase in the balance of Accumulated Depreciation is equal to the Depreciation expense for the budget period.

Van

Exam Tip: Students need to realise that when there is information about the Proceeds from Disposal of a Non-Current Asset in the question, students need to consider that there may have been a Profit or a Loss when the Non-Current Asset was disposed of. The \$6 000 increase in the Van value reported in the Balance Sheet does not represent a \$6 000 purchase of a Van. Apart from the phrase 'All non-current assets are sold and purchased using cash' in the question, the second indication that there may have been a Profit or a Loss on Disposal of a Non-Current Asset, is when the balance of Accumulated Depreciation decreases.

Alison's Appliances Balance Sheet (extract)	Actual 30 June 2025	Budgeted 30 June 2026
Non-Current Assets		
Van	36 000	42 000
Less: Accumulated Depreciation	(18 360)	(2 100)

- All non-current assets are sold and purchased using cash
- Proceeds from Disposal of Van \$12 000
- Depreciation Expense – Van \$6 510

Exam Tip: A past exam required students to reconstruct a number of accounts in order to ultimately calculate the amount paid for a Non-Current Asset. The Answer Booklet provided students with the Machinery account, the Accumulated Depreciation - Machinery account and the Disposal of Machinery account. The main issue students had was that the presentation of the accounts were not in the order there were required to be reconstructed. When provided with multiple accounts that require reconstruction, students should reconstruct the account with three out of the four entries provided in the question first.

Accumulated Depreciation - Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Disposal of Van	22 770		Balance	18 360
	Balance	2 100		Depreciation - Van	6 510
		24 870			24 870

Disposal of Van

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Van	36 000		Accumulated Depreciation - Van	22 770
				Bank	12 000
				Loss on Disposal - Van	1 230
		36 000			36 000

Accrued Wages

Alison's Appliances Balance Sheet (extract)	Actual 30 June 2025	Budgeted 30 June 2026
Current Liabilities		
Accrued Wages	-	1 800

- Wages Expense \$3 250 per month

Accrued Wages

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Bank	37 200		Balance	0
	Balance	1 800		Wages	39 000
		39 000			39 000

Alison's Appliances Budgeted Cash Flow Statement for the year ending 30 June 2026

	\$	\$
Cash Flow from Operating Activities		
Wages	(37 200)	

Alison's Appliances Budgeted Income Statement (extract) for the year ending 30 June 2026

	\$	\$
Less: Other Expenses		
Wages	39 000	

Exam Tip: This is an example of how the length of the budget period may be problematic for students. As the Wages expense is expressed as a monthly amount, the amount of Wages to be reported in the Budgeted Income Statement is the monthly amount multiplied by the number of months in the budget period. Students should avoid assuming that the budget period will always be annually. The 2018 VCAA exam required students to prepare a monthly budget. Whereas, the 2017 VCAA exam required students to prepare a quarterly budget.

Loan – CCA Bank

Exam Tip: Similarly to the \$6 000 increase in the balance of Van, just because the Non-Current Liability balance of the Loan owing to CCA Bank increased from \$16 000 to \$38 000, it does not necessarily mean that Alison's Appliances borrowed \$22 000. Students need to understand that the amount reported as a Current Liability on the actual Balance Sheet is the amount expected to be repaid within the next 12 months.

Alison's Appliances Balance Sheet (extract)	Actual 30 June 2025	Budgeted 30 June 2026
Current Liabilities		
Loan – CCA Bank	8 000	8 000
Non-Current Liabilities		
Loan – CCA Bank	16 000	38 000

- Quarterly Loan Repayments \$3 000 including \$1 000 interest

Loan – CCA Bank

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Bank	8 000		Balance	24 000
	Balance	46 000		Bank	30 000
		54 000			54 000

Alison's Appliances Budgeted Cash Flow Statement (extract) for the year ending 30 June 2026

	\$	\$
Cash Flows from Financing Activities		
Loan Borrowings – CCA Bank	30 000	
Loan Repayments – CCA Bank	(8 000)	

Owner's Equity Items

Capital

Exam Tip: If there is a difference between the total of Owner's Equity at the start of the budget period and the amount of Capital on the Budgeted Balance Sheet, there has been a Capital contribution made by the owner.

Alison's Appliances Balance Sheet (extract)	Actual 30 June 2025	Budgeted 30 June 2026
Owner's Equity		
Capital	84 650	67 370
Plus: Net Profit	14 320	25 750
Less: Drawings	31 600	20 000
	67 370	73 120

- All transactions between Alison and the business involve cash

Profit

Exam Tip: The amount of Profit reported in a Budgeted Balance Sheet provides students with a 'cross-checking mechanism' whereby the amount reported in the Budgeted Balance Sheet for Profit will be the same as the Profit reported in the Budgeted Income Statement.

Alison's Appliances Balance Sheet (extract)	Actual 30 June 2025	Budgeted 30 June 2026
Owner's Equity		
Capital	84 650	67 370
Plus: Net Profit	14 320	25 750
Less: Drawings	31 600	20 000
	67 370	73 120

Alison's Appliances Budgeted Income Statement (extract) for the year ending 30 June 2026

	\$	\$
Net Profit / (Loss)		25 750

Drawings

Exam Tip: As outlined previously, both Advertising and Drawings may not necessarily be entirely cash. The amounts could be partially cash and partially inventory.

Alison's Appliances Balance Sheet (extract)	Actual 30 June 2025	Budgeted 30 June 2026
Owner's Equity		
Capital	84 650	67 370
Plus: Net Profit	14 320	25 750
Less: Drawings	31 600	20 000
	67 370	73 120

Alison's Appliances Budgeted Cash Flow Statement (extract) for the year ending 30 June 2026

	\$	\$
Cash Flows from Financing Activities		
Loan Borrowings – CCA Bank	30 000	
Drawings	(20 000)	
Loan Repayments – CCA Bank	(8 000)	

The following pages contain the completed Budgeted Cash Flow Statements and Budgeted Income Statements.

Budgeting and Planning

The Budgeted Cash Flow Statement details the estimated cash inflows and cash outflows and calculates the expected Net Increase or Decrease in Cash Position at the end of the budgeted period. The Budgeted Cash Flow Statement aids planning by allowing the owner to prepare in advance for the expected Net Increase or Decrease so that problems can be managed and opportunities taken. This involves consideration of the amount of Capital made or Drawings taken by the owner, the capacity of the business to make loan repayments or whether an additional loan is required to finance the purchase of non-current assets.

The Budgeted Income Statement details the estimated revenues and expenses and calculates the expected Net Profit or Loss for the budgeted period. The Budgeted Income Statement aids planning as it indicates the future requirements of the business such as inventory and staffing levels.

Exam Tip: The focus of previous VCAA exams has certainly been on the practical component of budgeting. However, theory questions generally involve asking students to explain how budgeting assists with planning and control. Planning involves explaining what is included in the budgeted report and what the report ultimately calculates. Whereas, control involves the use of variance reports to identify unfavourable variances and taking corrective action. Students need to be careful to ensure their response addresses the issue in the question, whether that be planning or control.



“You can sum up this year’s budget with one word.”

Alison's Appliances
Budgeted Cash Flow Statement for the year ending 30 June 2026

	\$	\$
Cash Flow from Operating Activities		
Cash Sales	180 000	
GST Collected	18 000	
Receipts from Accounts Receivable	434 800	
Payments to Accounts Payable	(350 700)	
Purchases of Inventory	(83 000)	
Advertising	(17 500)	
Freight Inwards	(15 000)	
Interest	(4 000)	
General Expenses	(25 000)	
Prepaid Rent Expense	(48 000)	
Wages	(37 200)	
GST Paid	(24 050)	
GST Settlements	(2 440)	
Net Cash Flows from Operations		25 610
Cash Flows from Investing Activities		
Disposal of Van	12 000	
Purchase of Equipment	(10 000)	
Purchase of Van	(42 000)	
Net Cash Flows from Investing Activities		(40 000)
Cash Flows from Financing Activities		
Loan Borrowings – CCA Bank	30 000	
Drawings	(20 000)	
Loan Repayments – CCA Bank	(8 000)	
Net Cash Flows from Financing Activities		2 000
Net Increase / (Decrease) in Cash Position		(12 090)
Bank Balance at 1 July 2025		15 120
Bank Balance at 30 June 2026		3 030

Alison's Appliances
Budgeted Income Statement for the year ending 30 June 2026

	\$	\$
Revenues		
Cash Sales	180 000	
Credit Sales	420 000	
Less: Sales Returns	12 000	588 000
Less: Cost of Goods Sold		
Cost of Sales	392 000	
Freight Inwards	15 000	407 000
Gross Profit		181 000
Less: Inventory Loss		6 000
Adjusted Gross Profit		175 000
Add: Other Revenues		
Discount Revenue		9 000
		184 000
Less: Other Expenses		
Advertising	20 000	
Bad Debts	8 160	
Depreciation - Equipment	3 350	
Depreciation - Van	6 510	
Discount Expense	5 000	
General Expenses	25 000	
Interest Expense	4 000	
Loss on Disposal - Van	1 230	
Rent Expense	46 000	
Wages	39 000	158 250
Net Profit / (Loss)		25 750

APPLICATION EXERCISE 2

Westy's Wallets

On 1 July 2025 John West plans to start his own small business called Westy's Wallets.

John will only purchase and sell inventory on credit.

On 1 July 2025 the following events are expected to occur.

- John will contribute \$40 000 to start his business.
- The business will borrow \$30 000 from MNC Bank. Loan repayments of \$4 000 including \$1 000 interest will be made to MNC Bank on a quarterly basis. The first payment is due on 30 September 2025.
- Equipment costing \$25 000 plus GST will be purchased. The Equipment will be depreciated at a rate of 15% per annum.

John has provided you with the following information to be used to complete the budgeting process for the year ended 30 June 2026.

- Sales \$300 000 plus GST
- Sales Returns \$6 000 plus GST
- Receipts from Accounts Receivable \$293 400
- Payments to Accounts Payable \$161 700
- Mark-Up 100%
- Inventory Purchases \$175 000 plus GST
- Purchase Returns \$3 000 plus GST
- Inventory Loss \$2 000
- Advertising \$10 000 plus GST (includes \$1 500 of Inventory)
- Discount Expense \$2 500
- Discount Revenue \$7 500
- Doubtful Debts 1.5% of Net Sales
- Drawings \$25 000 (includes \$500 of Inventory)
- General Expenses \$15 000 plus GST
- GST Settlements \$1 620
- Rent Paid \$52 000 plus GST
- Wages \$3 000 per month

Expected closing balances as at 30 June 2026:

- Accounts Payable \$20 000
- Accounts Receivable \$27 500
- Accrued Wages \$1 500
- Inventory \$21 000
- Prepaid Rent Expense \$4 000

- Prepare the Budgeted Income Statement for the year ending 30 June 2026.
- Prepare the Budgeted Cash Flow Statement for the year ending 30 June 2026.

Download templates to complete all Application Exercises at <https://www.commpap.com/page90-2/>

VARIANCE REPORTS

A budget is an important tool for a sole proprietor to evaluate their performance.

Once the financial statements have been completed, the actual results should be compared to the amounts originally predicted in the budget.

Any variations between the actual amounts and the budgeted amounts should be calculated, problem areas identified and corrective action taken. This may involve adjusting any future budgets as a result of such a review.

Within a business environment, management may use an actual result that exceeds a budgeted result as a basis for reward.

Exam Tip: When asked to complete a Variance Report, the following rules must be followed.

Favourable Variance: Actual Result better than Budgeted Result

Unfavourable Variance: Actual Result worse than Budgeted Result

It is only when students are asked to explain whether the variance is favourable or unfavourable that students can move away from these rules and justify whether they believe the variance is favourable or unfavourable. For example, in the Cash Flow Statement Variance Report (extract) below, students would identify that the Advertising variance is unfavourable as the actual amount paid was greater than the budgeted amount. However, it could be argued that the favourable variance in Cash Sales was as a direct consequence of the unfavourable Advertising variance.

Cash Flow Statement Variance Report

The Budgeted Cash Flow Statement aids decision-making as it sets a benchmark for which the actual cash performance can be assessed. By comparing budgeted and actual cash flows, problems areas can be identified and corrective action taken. Areas such as Purchases of Inventory, Advertising, Wages, Investing and Financing activities are often items that warrant student consideration.

Alison's Appliances

Cash Flow Statement Variance Report (extract) for the year ending 30 June 2026

	Budget	Actual	Variance	Favourable / Unfavourable
Cash Flow from Operating Activities				
Cash Sales	180 000	210 560	30 560	F
Receipts from Accounts Receivable	434 800	407 900	26 900	U
Purchases of Inventory	(83 000)	(92 140)	9 140	U
Advertising	(17 500)	(22 800)	5 300	U
Wages	(37 200)	(46 600)	9 400	U
Cash Flows from Investing Activities				
Purchase of Van	(42 000)	(47 990)	5 990	U
Cash Flows from Financing Activities				
Loan – CCA Bank	30 000	40 000	10 000	F
Drawings	(20 000)	(18 000)	2 000	F

Exam Tip: When analysing a Variance Report, students need to make connections between items presented. For example, the Cash Flow Statement Variance Report (extract) for Alison's Appliances identifies an unfavourable variance for the Purchase of Van yet a favourable variance for the Loan - CCA Bank. This can be explained by realising that the business had to borrow more than expected from CCA Bank as the Van purchased cost more than expected. Even though the Loan - CCA Bank variance is favourable, as the actual cash received was larger than the budgeted cash received, the consequences would be expected to be unfavourable as actual Interest paid would be larger than the budgeted interest paid.

Income Statement Variance Report

The Budgeted Income Statement aids decision-making as it sets a benchmark for which the actual trading performance can be assessed. By comparing budgeted and actual revenues and expenses, problems areas can be identified and corrective action taken. Areas such as Sales, Sales Returns, mark-up percentage, Inventory losses and individual expense items are often areas that warrant student consideration.

Alison's Appliances

Income Statement Variance Report (extract) for the year ending 30 June 2026

	Budget	Actual	Variance	Favourable / Unfavourable
Credit Sales	420 000	429 380	9 380	F
Sales Returns	12 000	9 670	2 330	F
Inventory Loss	6 000	5 250	750	F
General Expenses	25 000	31 400	6 400	U
Interest Expense	4 000	5 500	1 500	U

BUDGETING LIMITATIONS

Even though the budgeting process provides a business with an opportunity to plan and then evaluate their performance, budgeting does have its limitations. Within a sole proprietor environment, the budgeting process can be time consuming and the owner may well be tempted to be overly ambitious in setting unrealistic goals.

Budgeting is a game. It is a game involving employees, managers and business owners. Employees and managers want to set targets by which their performance can be assessed. Business owners also want to set targets by which their employees and managers' performance can be assessed. The compromise between all parties involved in the budgeting process may lead to unethical behaviour.

As employees and managers are held accountable for their actual performance compared with the budget, they may attempt to understate revenues and overstate expenses when setting budgets in order to be seen to performing above expectations. Whereas, business owners are often seen as imposing overly ambitious budget goals on managers and employees which, in turn, can see managers and employees adopt unethical behaviour such as not completing jobs in accordance with usual high standards or reporting misleading internal monthly data.

As outlined above, budgets can effect human behaviour. Budgets can be motivational or demoralising for employees and managers alike. It can be argued that budget variances should not be the only basis for recognition and reward for employees and managers. Instead of focusing only on sales targets, a combination of both financial and non-financial indicators can be used as a means of assessing employee and manager performance.

Question 1 (44 marks)

Charlotte Aston of Charlotte's Chairs has employed you to assist in finalising the budgeting process for the year ended 30 June 2026.

Charlotte has provided the following information to be included in your budgeting process.

Charlotte's Chairs Balance Sheet	Actual 30 June 2025	Budgeted 30 June 2026
Current Assets		
Cash at Bank	-	7 680
Accounts Receivable	21 800	15 000
Less: Allowance for Doubtful Debts	820	1 900
Inventory	25 500	20 000
Prepaid Rent Expense	9 000	10 000
	55 480	50 780
Non-Current Assets		
Equipment	26 800	32 800
Less: Accumulated Depreciation	(16 080)	(15 975)
	10 720	16 825
Total Assets	66 200	67 605
Current Liabilities		
Bank Overdraft	15 230	-
Accounts Payable	16 500	10 000
Accrued Wages	-	2 000
GST Clearing	1 290	3 000
Loan – MNC Bank	12 000	12 000
	45 020	27 000
Non-Current Liabilities		
Loan – MNC Bank	12 000	9 000
Owner's Equity		
Capital	42 190	13 180
Plus: Net Profit	(10 110)	54 425
Less: Drawings	22 900	36 000
	9 180	31 605
Total Equities	66 200	67 605

Additional information (expected during 2026)

Sales	\$300 000 plus GST
Credit Sales	70%
Sales Returns	\$6 000 plus GST
Mark-Up	150%

All inventory returned by customers are then returned to the supplier for a full credit.

Credit Purchases of Inventory	80%
Inventory Loss	\$1 500

All transactions between Charlotte and the business involve cash.

Advertising	\$5 000 plus GST (includes \$1 000 of Inventory)
Bad Debts Written Off	\$3 300 including GST
Discount Expense	\$2 500
Discount Revenue	\$4 000
Doubtful Debts	2% of Net Credit Sales

Equipment with a cost price of \$8 000 and a carrying value of \$3 200 is expected to be sold for \$2 000 on 1 October.

Equipment is expected to be purchased on 1 October for \$14 000 plus GST.

Equipment is depreciated using straight-line method at 15% per annum.

General Expenses	\$30 000 plus GST
GST Paid	\$9 540
GST Settlements	\$8 730
Interest Expense	\$5 000
Prepaid Rent Expense Paid	\$24 000 plus GST
Quarterly Loan Repayments	\$3 000
Wages Expense	\$49 000

- Reconstruct the Accounts Receivable ledger in order to calculate budgeted Receipts from Accounts Receivable for the year ending 30 June 2026.

5 marks
- Reconstruct the Inventory and Accounts Payable ledgers in order to calculate budgeted Payments to Accounts Payable for the year ending 30 June 2026.

12 marks
- Prepare the Budgeted Income Statement for the year ending 30 June 2026.

13 marks
- Prepare the Budgeted Cash Flow Statement for the year ending 30 June 2026.

14 marks

Question 2 (6 marks)

Larry McBride owns and operates Larry's Ladders.

Larry has provided the following incomplete Variance Reports extracts.

Larry's Ladders**Cash Budget****Variance Report (extract) for the year ended 31 December 2026**

	Budget	Actual	Variance	Favourable / Unfavourable
Cash Sales		\$217 500	\$7 500	U
Receipts from Accounts Receivable	\$220 000	\$252 000	\$32 000	
Advertising	\$15 000	\$19 500	\$4 500	U

Larry's Ladders**Income Statement****Variance Report (extract) for the year ended 31 December 2026**

	Budget	Actual	Variance	Favourable / Unfavourable
Credit Sales	\$235 000	\$259 000		F
Inventory Loss	\$4 600		\$3 960	U
Discount Expense	\$9 000	\$11 800	\$2 800	U

- In the Answer Booklet, complete the variance report extracts. 2 marks
- Explain how the preparation of variance reports helps specifically with Larry's decision making. 2 marks
- Explain why Larry may view the Discount Expense variance as favourable. 2 marks

END OF MINI EXAM NO. 4

YOU BE THE ASSESSOR: UNIT 4 AREA OF STUDY 2

In this section, you are required to assess the responses presented for each of the questions. You should award the responses a score and justify your decision. Once complete, compare your assessment to that of the author provided at the CPAP website <http://www.commpap.com/page90.html>

Question 1 (2014 VCAA Exam Question 9 – modified and includes Doubtful Debts)

Lou's Lighting reports and budgets on a monthly basis. The business has been preparing its budgets for July 2014 and has completed the Budgeted Balance Sheet and Budgeted Income Statement.

The following information is provided.

Lou's Lighting Balance Sheet (extract)	Actual 30 June 2014	Budgeted 31 July 2014
Current Assets		
Accounts Receivable	32 700	40 000
Inventory	72 000	90 000
Non-Current Assets		
Equipment	37 000	42 000
Less: Accumulated Depreciation	(19 000)	(7 000)
Owner's Equity		
Less: Drawings	(44 000)	(32 000)

Budgeted Income Statement items for the month ending 31 July 2014

	\$
Sales	202 000
Profit on Disposal of Equipment	3 700
Sales Returns	1 500
Cost of Sales	100 250
Inventory Write-Down	2 000
Depreciation – Equipment	3 200
Discount Expense	1 500

Additional information

- All sales are on credit.
- All purchases of inventory are made on a cash basis.
- Cost of Sales is 50% of sales.
- Bad debts to be written off total \$2 200 including GST.
- Equipment costing \$25 000 and with a carrying value of \$9 800 will be sold for cash.
- New Equipment will be purchased for cash.
- Drawings by the owner will include \$3 000 inventory.

Reconstruct the following General Ledger accounts:

- Accounts Receivable – to determine cash to be received from outstanding balances
- Inventory – to determine cash to be paid for inventory
- Disposal of Equipment – to determine cash to be received from sale of equipment

8 marks

SAMPLE ANSWER A

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Balance	32 700		Bank	189 700
	Credit Sales	202 000		Sales Returns	1 500
				Discount Expense	1 500
				Allowance for Doubtful Debts	2 000
				Balance	40 000
		234 700			234 700

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Balance	72 000		Cost of Sales	100 250
	Bank	120 250		Inventory Write Down	2 000
				Balance	90 000
		192 250			192 250

Disposal of Equipment

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Equipment	25 000		Acc. Dep. - Equipment	9 800
				Profit on Disposal of Equipment	3 700
				Bank	11 500
		25 000			25 000

Justification _____

SAMPLE ANSWER B

Accounts Receivable

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Balance	32 700		Bank	209 550
	Credit Sales	202 000		Sales Returns	1 500
	GST Clearing	20 200		GST Clearing	150
				Discount Expense	1 500
				Allowance for Doubtful Debts	2 000
				GST Clearing	200
				Balance	40 000
		254 900			254 900

Inventory

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Balance	72 000		Cost of Sales	101 000
	Cost of Sales	750		Inventory Write Down	2 000
	Bank	123 250		Drawings	3 000
				Balance	90 000
		196 000			196 000

Disposal of Equipment

Date	Cross-reference	Amount	Date	Cross-reference	Amount
	Equipment	25 000		Acc. Dep. - Equipment	15 200
	Profit on Disposal of Equipment	3 700		Bank	13 500
		28 700			28 700

Justification _____

Question 2 (2015 VCAA Exam Question 9)

Terry’s Timber has recently commenced reporting on a monthly basis.

The business sells on credit and pays cash for purchases.

The business has provided relevant account balances, both actual and budgeted, for October 2015.

Account balances	1 October (actual)	31 October (budgeted)
Accrued Wages	1 700	1 900
Accounts Receivable	48 000	51 000
GST Clearing	600 Cr	not provided
Loan – NIM Bank	120 000	115 000
Machinery	90 000	90 000
Prepaid Rent	2 000	not provided

Additional information (budgeted) for October

- The business expects credit sales of \$50 000 (plus GST) in October.
- Wages paid will be \$23 200.
- Rent is paid three months in advance at \$2 000 per month plus GST. The next payment will be in October. The rent charged will increase by 10% from 1 December onwards.
- Interest on the loan is \$5 400 per annum. It is paid half yearly in March and October.
- Cost of Sales is 50% of Sales Revenue.
- Cash purchases of inventory are budgeted to be \$18 000 (plus GST).
- The depreciation on the machinery is 12% per annum straight-line.

Prepare the Operating section of the Budgeted Cash Flow Statement for the month ending 31 October 2015.

7 marks

SAMPLE ANSWER A

**Terry’s Timber
Budgeted Cash Flow Statement (extract)
for the month ending 31 October 2015**

	\$	\$
Cash Flow from Operating Activities		
Receipts from Accounts Receivable	55 000	
Wages	24 900	
Interest Paid	5 400	
Purchases of Inventory	18 000	
Rent	6 000	
GST Paid	2 400	
		(1 700)

Justification _____

SAMPLE ANSWER B

**Terry's Timber
 Budgeted Cash Flow Statement (extract)
 for the month ending 31 October 2015**

	\$	\$
Cash Flow from Operating Activities		
Receipts from Accounts Receivable	52 000	
Wages	(23 200)	
Interest Paid	(2 700)	
Purchases of Inventory	(18 000)	
Rent	(6 400)	
GST Paid	(2 440)	
Net Cash Flows from Operations		(740)

Justification _____

Prepare a Budgeted Income Statement for the month ending 31 October 2015.

5 marks

SAMPLE ANSWER A

**Terry's Timber
 Budgeted Income Statement
 for the month ending 31 October 2015**

	\$	\$
Revenues		
Sales		50 000
Less: Cost of Goods Sold		
Cost of Sales		33 334
Gross Profit		16 666
Less: Other Expenses		

Depreciation - Machinery	900	
Interest Expense	2 700	
Rent Expense	2 000	
Wages	25 100	30 700
Net Profit / (Loss)		(14 034)

Justification _____

SAMPLE ANSWER B

**Terry's Timber
Budgeted Income Statement
for the month ending 31 October 2015**

	\$	\$
Revenues		
Sales		50 000
Less: Cost of Goods Sold		
Cost of Sales		25 000
Gross Profit		25 000
Less: Other Expenses		
Depreciation - Machinery	900	
Interest Expense	450	
Rent Expense	2 000	
Wages	23 400	26 750
Net Profit / (Loss)		(1 750)

Justification _____

Question 3 (2017 VCAA November Exam Question 8 modified)

Tippy Toys is a new business that will commence trading in July 2018. Sales will be on a cash basis while inventory purchases will be on credit. Credit terms are 5/14, n/30.

The owner has provided the following estimates for the six months ending 31 December 2018:

- Sales (all excluding GST) are expected to be \$25 000 per month from July to October, then \$45 000 in November and \$65 000 in December.
- The business will use a mark-up of 100% on cost.
- Inventory purchases are budgeted to be \$130 000 (plus GST).
- Suppliers are to be paid promptly and the discount will always be taken. The Accounts Payable balance at 31 December 2018 is estimated to be \$15 000.
- Wages expense is expected to be \$7 000 per month, payable fortnightly. An accrual of \$144 will be required for wages on 31 December 2018.
- Advertising of \$2 000 (plus GST) will be paid in July 2018. A further \$9 000 (plus GST) will be paid in November for a three-month advertising campaign commencing 1 December 2018.
- Insurance for the first year will be \$8 400 (plus GST), to be paid on 1 July 2018.
- Shop rent is \$2 000 (plus GST) per month, payable four months in advance, with payments due on the first day of July, November and March each year.
- Shop fittings costing \$45 000 (plus GST) will be purchased and ready for use by 1 October 2018. The shop fittings are expected to have a useful life of five years and a residual value of \$15 000. The shop fittings will be depreciated using the straight-line method.

Prepare the Budgeted Income Statement for the six months ending 31 December 2018.

8 marks

SAMPLE ANSWER A

Tippy Toys

Budgeted Income Statement for the six months ending 31 December 2018

	\$	\$
Revenues		
Sales		135 000
Less: Cost of Goods Sold		
Cost of Sales		67 500
Gross Profit		67 500
Add: Other Revenues		
Discount Revenue		7 150
		74 650
Less: Other Expenses		
Advertising	8 000	
Depreciation – Shop Fittings	3 000	
Insurance	8 400	
Rent Expense	12 000	
Wages	42 144	73 544
Net Profit / (Loss)		1 106

Justification _____

SAMPLE ANSWER B

Tippy Toys

Budgeted Income Statement for the six months ending 31 December 2018

	\$	\$
Revenues		
Sales		210 000
Less: Cost of Goods Sold		
Cost of Sales		105 000
Gross Profit		105 000
Add: Other Revenues		
Discount Revenue		6 400
		111 400
Less: Other Expenses		
Advertising	5 000	
Depreciation – Shop Fittings	1 500	
Insurance	4 200	
Rent Expense	12 000	
Wages	42 000	64 700
Net Profit / (Loss)		46 700

Justification _____

BONUS PRACTICE EXAM (100 MARKS)

Question 1 (14 marks)

On 1 January 2025 Marie Kondo started her own small business called Marie's Mirrors.

On the same day, the follow events occurred.

- Marie opened a business bank account with an electronic transfer of \$20 000 from her personal account.
- Marie transferred ownership of her Van to the business. She purchased the Van in 2023 for \$38 990 plus GST. Marie decided that the Van's fair value was \$18 500.
- Marie's Mirrors borrowed \$30 000 from MNC Bank and arranged a \$5 000 overdraft limit. Loan repayments of \$1 500 will be made to MNC Bank on a quarterly basis.
- Inventory costing \$16 500 plus GST was purchased on credit.
- Paid Rent for January, February and March at \$2 200 per month including GST.

- a. Prepare a classified Balance Sheet for Marie's Mirrors as at 1 January 2025. 6 marks
- b. Referring to two qualitative characteristics, explain why fair values should be used when non-cash assets are contributed to the business by an owner. 4 marks
- c. Referring to the definition of a liability, explain how the loan balance owing to MNC Bank would be treated differently to the bank overdraft limit on the Balance Sheet of Marie's Mirrors as at 1 January 2025. 4 marks

Question 2 (14 marks)

Tom Melbourne owns and operates Tom's Tents, a small business that uses the FIFO (First In, First Out) cost assignment method.

Details of the 'Kensington' tent for February 2025 are shown below.

01/02	Balance – 3 tents with a cost price of \$100 each.
09/02	Credit purchase of 10 tents from MRF for \$90 plus GST each (Invoice 773). These were the only stock items purchased by Tom's Tents from MRF on this day.
09/02	Don's Deliveries paid \$60 plus GST for the delivery of the 10 tents from MRF. (EFT 9276)
14/02	Credit sale of 5 units for \$330 plus GST each to Chadstone Scouts (Invoice 209).
18/02	Chadstone Scouts returned 1 tent as it was damaged. (Credit Note 27).

- a. Using product costing, record all information provided for the 'Kensington' tent in the General Journal.
Narrations are **not** required. 12 marks
- b. Explain the effect on the Income Statement for the month ended 28 February 2025 if Tom's Tents used period costing instead of product costing assuming not all the items are sold. 2 marks

Question 3 (6 marks)

James Heard, the owner of James' Jackets, doesn't believe in the concept of debt, whether that be offering credit terms to customers or borrowing money from a bank.

Discuss whether the introduction of offering credit terms to customers and borrowing money from a bank will improve the profitability of James' Jackets.

Question 4 (10 marks)

Marianne Williamson owns and operates Williamson’s Windows, a small business that sells windows in Australia on behalf of Kamala, an overseas business based in Asia.

The following source document was found in the offices of Williamson’s Windows.

KAMALA 88 Main Road Dhaka Bangladesh STATEMENT OF ACCOUNT				
Account Name: Williamson’s Windows 101 Strong Street CAPITAL CITY VIC 3000 Date: 31 March 2025				
Date	Details	Debit	Credit	Balance
01/03	Balance			6 600 DR
04/03	Payment Received		6 468	132 DR
04/03	Discount Allowed		132	Nil
09/03	Invoice 349	10 560		10 560 DR
11/03	Credit Note 17		550	10 010 DR
29/03	Payment Received		2 000	8 010 DR

- Show how the Accounts Payable ledger account would appear in the General Ledger of Williamson’s Windows as at 31 March 2025. You **are** required to balance the ledger account. 6 marks
- Explain how the Statement of Account could assist internal control for Williamson’s Windows. 2 marks
- Ethical one ethical issue Williamson’s Windows should consider when agreeing to sell windows on behalf of Kamala in Australia. 2 marks

Question 5 (11 marks)

Andrew Yang, the owner of Andrew’s Air Conditioners, has employed you to assist in finalising his budgeting process for the year ended 30 June 2026.

Andrew has provided the following information to be included in your budgeting process.

	Actual Balance Sheet as at 30 June 2025	Budgeted Balance Sheet as at 30 June 2026
Non-Current Assets		
Equipment	24 100	28 200
Less: Accumulated Depreciation	13 940	9 800
	10 160	18 400

**Andrew's Air Conditioners
Budgeted Cash Flow Statement (extract)
for the year ended 30 June 2026**

Cash Flow from Investing Activities	\$
Disposal of Equipment	1 750

**Andrew's Air Conditioners
Budgeted Income Statement (extract)
for the year ended 30 June 2026**

Other Expenses	\$
Depreciation – Equipment	3 920
Loss on Disposal – Equipment	2 590

- Reconstruct the accounts provided in the Answer Booklet to calculate the budgeted cash purchase of Equipment for the year ended 30 June 2026. 7 marks
- Explain why Andrew's Air Conditioners would have a budgeted Loss on Disposal – Equipment. 2 marks
- Explain how the preparation of a Budgeted Cash Flow Statement can assist Andrew's Air Conditioners with controlling their future cash flows. 2 marks

Question 6 (24 marks)

Tulsi Gabbard owns and operates Tulsi's Televisions, a small business that prepares reports on a half-yearly basis on 30 June and 31 December.

Tulsi has provided you with the following Pre-adjustment Trial Balance (extract) as at 30 June 2025.

**Tulsi's Televisions
Pre-Adjustment Trial Balance (extract) as at 30 June 2025**

Account	Debit	Credit
Accumulated Depreciation - Equipment		4 400
Capital		58 290
Cash Sales		28 970
Cost of Sales	30 990	
Credit Sales		51 480
Discount Revenue		506
Drawings	9 570	
Equipment	23 900	
Interest Revenue		600
Prepaid Rent Expense	38 600	
Sales Returns	3 700	
Term Deposit	30 000	

Additional information

- Cash purchase of Equipment of \$9 900 including GST was made on 1 April 2025.
- Equipment is depreciated at a rate of 20% per annum using the reducing balance method.
- A 12 month term deposit of \$30 000 started on 1 November 2024. Interest of 6% per annum is paid quarterly on 31 January, 30 April, 31 July and 31 October.
- Rent is paid yearly in advanced. The most recent payment of \$33 600 plus GST was made on 1 February 2025 for the year ending 28 February 2026.
- On 16 April 2025 Mary took 3 'Accomplish' magnet sets for personal use. Each of these magnet sets has a cost price of \$40 plus GST and a selling price of \$90 plus GST. This event had not been recorded.
- On 14 June 2025 Mary made a capital contribution of \$15 000 cash.
- As at 30 June 2025 Wages owing were \$1 500.

- Explain the benefit of preparing a Pre-adjustment Trial Balance. 2 marks
- Calculate the carrying value for the Equipment as at 30 June 2025. 4 marks
- Justify Tulsi's choice of depreciating the Equipment using the reducing balance method. 2 marks
- Prepare the General Journal entry required to close the Revenue accounts on 30 June 2025.
A narration is **not** required. 5 marks
- Apart from determining profit, state one reason why Revenue accounts are required to be closed. 1 mark

Total expenses of \$56 110 were closed to the Profit and Loss Summary account on 30 June 2025.

- Show how the Prepaid Rent Expense and Capital accounts would appear in the General Ledger after all adjusting, closing and transfer entries have been posted.

You are **not** required to balance either account. 7 marks

On 4 July 2025 Wages of \$1 800 were paid.

- Explain the effect on the Accounting equation of recording the payment. 3 marks

Question 7 (6 marks)

The accountant of Peter's Plates has provided the following information.

Indicator	2024	2025
Total Sales	\$300 000	\$450 000
Gross Profit Margin	55%	45%
Net Profit Margin	8%	7%
Assets	\$200 000	\$275 000

- Discuss whether Peter would be happy with the profitability of his business. 5 marks
- State one non-financial indicator Peter could use to assess the performance of his business. 1 mark

Question 8 (9 marks)

Graham Lindsay owns and operates Graham's Gates, a small business that prepares reports on a monthly basis. The information contained in the Bank General Ledger account for August 2025 has been summarised as follows.

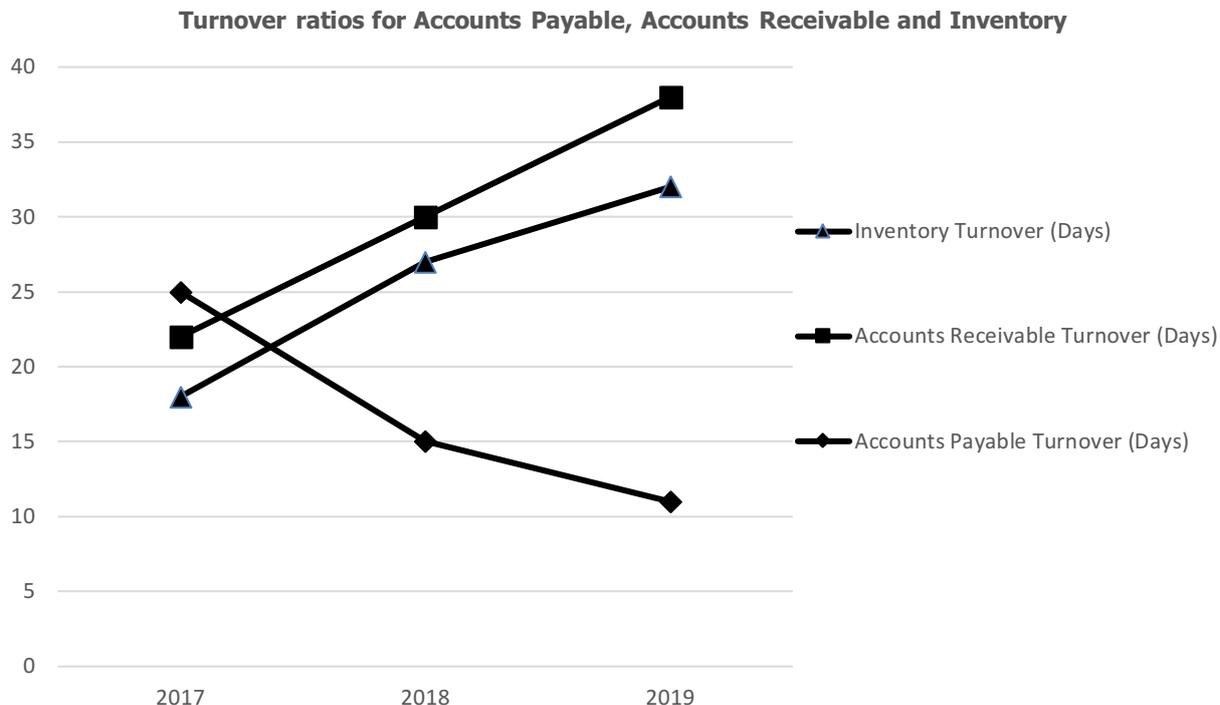
Summary of Receipts	\$	Summary of Payments	\$
Capital	20 000	Advertising	600
Cash Sales	12 800	Cartage Inwards	1 030
Disposal of Van	7 500	Cartage Outwards	550
GST Collected	1 280	Drawings	2 000
Loan Borrowings – MNC Bank	15 000	GST Paid	4 197
Receipts from Accounts Receivable	3 300	GST Settlement	984
		Interest Paid	140
		Loan Repayments – MNC Bank	375
		Payments to Accounts Payable	6 600
		Prepaid Rent Expense	15 000
		Purchases of Inventory	4 800
		Purchase of Van	19 990
		Wages	4 500
	59 880		60 766

- a. Prepare the Net Cash from Operations extract from the Cash Flow Statement for the month ending 31 August 2025. 6 marks
- b. Explain to Graham, with the use of an example, how the Cash Flow Statement reported a negative Net Cash from Operations but the Income Statement reported a Net Profit. 3 marks

Question 9 (6 marks)

Schwerkolt's Shoes is a small business that offer their customers credit terms of 2/7, n/30 and have credit terms of 5/5, n/14 with their only supplier.

The accountant has provided the following information.



- a. Explain the impact of the trends on the liquidity and stability of Schwerkolt's Shoes. 4 marks
- b. State one strategy the owner could introduce to improve the Inventory Turnover in 2026 1 mark
- c. State one strategy the owner could introduce to improve the Accounts Receivable Turnover in 2026. 1 mark

100 marks

END OF QUESTION BOOKLET

EXAMINATION PREPARATION STRATEGY

Your overall strategy for exam preparation for should be to **KLAP**:

1. **Know** the course and know how to interpret examination questions.....
2. **Learn** from your experience in assessment tasks to maximise your performance
3. **Avoid** common errors made by students in previous examinations....
4. **Practice**, practice and practice writing responses to questions.....

Knowing the course shouldn't be too difficult if you have followed this Study Guide closely and supplemented it with teachers' notes and other resources.

General things to do to help you know the course are:

- Prepare a summary of the course;
- Condense your notes;
- Update your list of key terms and concepts for each topic; and
- Revisit and update your templates of the Journals, Ledgers and Reports so you know 'what goes where' and what 'additions' there have been.
- Download the document titled '**Must Know Content and Skills for Exam**' at <https://www.commpap.com/page90-2/>

Knowing how to interpret questions remains a key. The completion of assessment tasks and practice questions should allow students to develop and/or refine their examination technique. Interpretation of questions should be second nature at this point regularly. However, there is still the initial reaction to the examination once you are told to 'commence reading'.

Remember:

- Read through the examination twice – students will read it quite quickly the first time. A second look will calm them down and help them gather their thoughts and plan their attack.
- Read the Question Book and the Answer Booklet in tandem. Make absolutely sure of what is required for each question.
- Identify the 'easy' questions. The examination is set out in such a way that questions do not need to be completed in order. Some questions are independent of the material presented earlier and students can do these questions first if they are comfortable with them – it can be a great way to boost their confidence for other questions.
- Check the mark allocation for each question. This should give students an indication of how much time to spend on a question and what is required.

Avoid common errors made by students in previous examinations.

Assessment Reports/Examination Reports should be read in their entirety to get a feel for the common mistakes made by students. Despite the new Study Design n 2025, there have not been significant changes to the course, so students should not be too concerned about using reports that relate to the previous Study Design. Careful reading of the Exam Tips in this publication, as well as completion of the 'You Be the Assessor' sections will also help students to avoid some of the common errors.

Practice, Practice, Practice

Once you know the course and have anticipated questions, you need to practice answering these questions within time constraints. This will involve you estimating the number of marks that is likely to be awarded for each of your anticipated questions. Remember, you will have 120 minutes in the examination to answer 100 marks worth of questions. Following this, you should access as many practice exams as you can and attempt them under strict time constraints. Your teacher should have access to practice exams from various sources, including 'Compak' and 'the CPAP Practice Exams (www.commpap.com)'. Don't forget the Bonus Exam in this publication as well as the mini exams relating to each area of study.

Below are a list of theory questions that have been asked in recent exams that students should practice:

2019 VCAA Exam

With reference to one accounting assumption, explain why it is necessary to record the additional information. (Balance Day Adjustments) 3 marks

2020 VCAA Exam

With reference to one accounting assumption, explain why this balance day adjustment (Wages owing to employees) is necessary. 3 marks

2021 VCAA NHT Exam

With reference to one accounting assumption, explain in which month the revenue should be recognised. 3 marks

With reference to one accounting assumption, explain why it is necessary to close revenue and expense accounts at the end of the reporting period. 3 marks

2021 VCAA Exam

With reference to one qualitative characteristic, explain the importance of recording from source documents. 3 marks

2022 NHT VCAA Exam

Identify and explain one accounting assumption that would be breached if the accountant agreed to this request. (using a shorter useful life). 3 marks

2022 VCAA Exam

With reference to one accounting assumption, explain the purpose of the Allowance for Doubtful Debts account. 3 marks

Explain one qualitative characteristic, other than relevance, that is being breached due to this delay in reporting. 3 marks

With reference to one accounting assumption, explain why revenue and expense accounts need to be closed at the end of each reporting period. 3 marks

2023 NHT VCAA Exam

Referring to an accounting assumption, explain why an adjustment is required for prepaid rent. 3 marks

Explain how the balance of Accounts Receivable would be classified on a Balance Sheet. 3 marks

Explain how the balance of Inventory would be classified on a Balance Sheet. 3 marks

Explain how the balance of Prepaid Rent Expense would be classified on a Balance Sheet. 3 marks

Explain how a Van would be classified on a Balance Sheet. 3 marks

Explain how Accrued Wages would be classified on a Balance Sheet. 3 marks

Explain how a loan would be classified on a Balance Sheet. 3 marks

Explain how reporting Sales Returns separately in an Income Statement satisfies the qualitative characteristic of relevance. 3 marks

Explain how Discount Revenue satisfies the definition of the revenue accounting element. 3 marks

Explain how Discount Expense satisfies the definition of the expense accounting element. 3 marks

Explain how Depreciation Expense satisfies the definition of the expense accounting element. 3 marks

Explain why there was a loss or a profit on the trade-in of the Van. 3 marks

Explain why asset accounts are not required to be closed at the end of the reporting period. 3 marks

Explain why liability accounts are not required to be closed at the end of the reporting period. 3 marks

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