



UNITS
1&2


5TH
EDITION

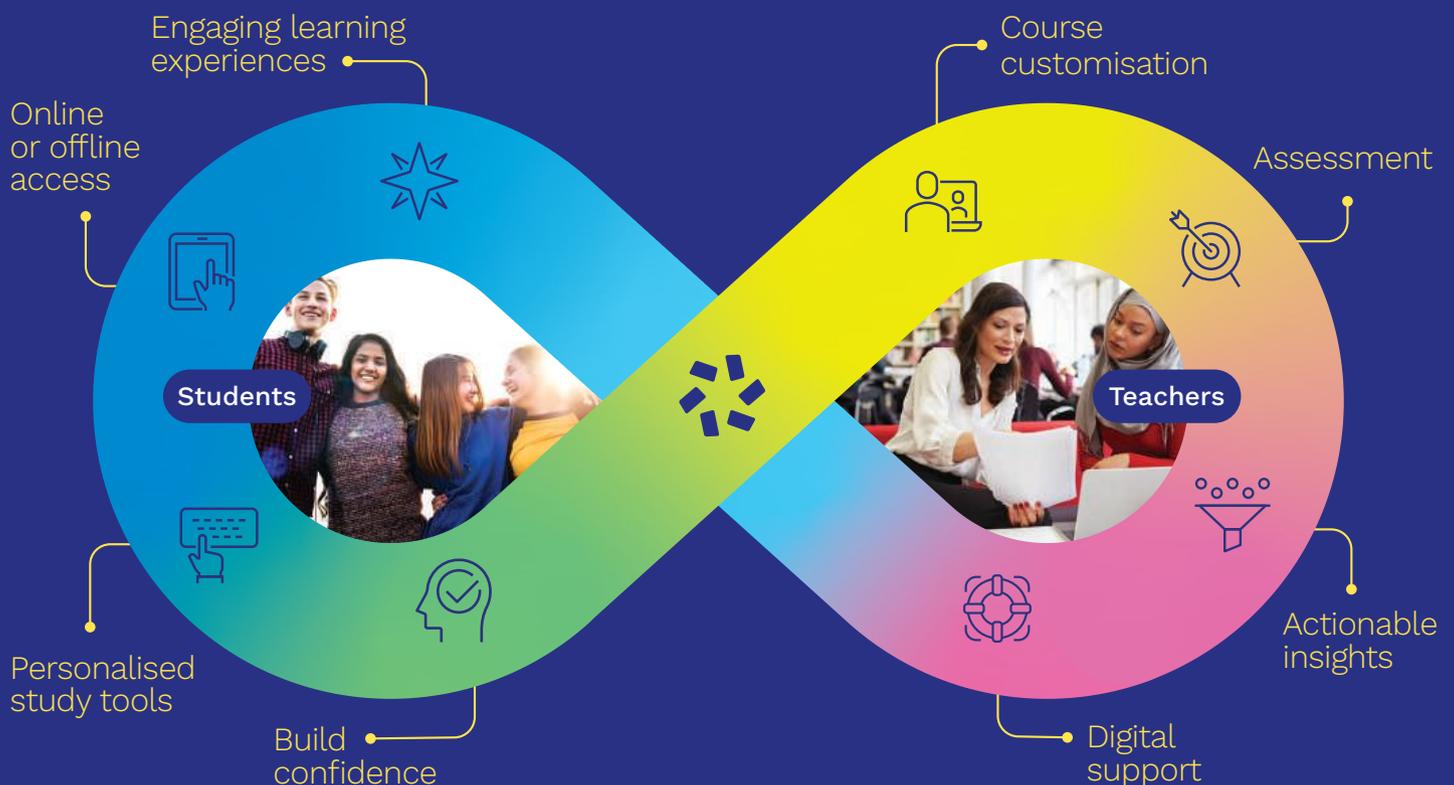
AN INTRODUCTORY FRAMEWORK

TREVOR
STANLEY
CHRIS
RYAN

ACCOUNTING

Learning that puts you at the centre

...and on the learning path to success.



Find everything you need to access your Nelson MindTap course at cengage.com.au/nelsonmindtap



COPYRIGHT NOTICE

Copyright in this work is owned by Cengage Learning Australia (“the work”). A condition of purchase of this electronic version of the work is that you agree to respect the copyright in the work, abide by the Copyright Act 1968 and specifically agree not to transfer, sell, assign, misuse, copy or transmit an electronic or other version of the work to any third party.

Please note: This product is accompanied by a licence (single user, network or adoption) governing the terms and conditions of its use.

This is a legal agreement between the you, (the “Customer”) and Cengage Learning Australia Pty Limited (ABN 14 058 280 149) (the “Licensor”) which provides the terms and conditions of this non-exclusive licence and the limited warranty for the Product. Use of the Product indicates an acknowledgement that the Customer has read and agreed to be bound by the terms and conditions of this Agreement. If you do not agree to these terms and conditions, return the Product to the place of purchase within 15 days of the date of purchase (with proof of purchase) for a full refund

1. Licence Grant

You do not receive title to the Product. Copyright in the Product (which includes all images, photographs, video, animations, audio, music and text incorporated in the Product, including all of the accompanying printed material) is owned by the Licensor and/or its suppliers and is protected by Australian copyright laws. The Licensor grants you a non-exclusive licence to use the Product subject to the restrictions and terms set out in this Agreement.

2. A Licence allows you to:

Use the Product on your computer. The Customer represents that they shall in no way place the Product in the public domain or in any way compromise our copyright in the Material. You agree to take reasonable steps to protect our copyright.

3. You may not:

Alter, modify, translate, reverse engineer, decompile, or adapt the software or create derivative works based on the Product. Make further copies by any means technological, electronic, digital whatsoever without the written permission of the Licensor. Rent or transfer all or any part of your rights under this Agreement. Remove or alter any copyright or other proprietary notice or label attached to the software.

4. Termination

Any failure to comply with the terms and conditions of this agreement will result in the automatic termination of this licence. Upon termination of this licence for any reason, the Customer must destroy or return to the Licensor all copies of the software and accompanying documentation.

5. Warranties

To the extent permitted by law, the Licensor’s liability for any breach of the warranty or any term implied by law into this licence is limited to the lowest cost of replacing the goods, acquiring equivalent goods or having the goods repaired.

5TH
EDITION

UNITS
1&2

AN INTRODUCTORY FRAMEWORK

TREVOR
STANLEY

CHRIS
RYAN

ACCOUNTING

Accounting: An Introductory Framework Units 1&2
5th Edition
Trevor Stanley
Chris Ryan
ISBN 9780170481144

Product manager: Melissa O'Shea
Content developer: Lynley Bidlake/Katrina Stavridis
Content manager: Karen Young
Associate content project manager: Garima Singh
Text designer: Cengage Creative Studio
Cover designer: Danielle Maccarone
Editor: Lauren McGregor
Proofreader: Natasha Broadstock
Permissions/Photo researcher: Lumina Datamatics
Cover: stock.adobe.com/kitka
Typeset by Straive

Any URLs contained in this publication were checked for currency during the production process. Note, however, that the publisher cannot vouch for the ongoing currency of URLs.

© 2025 Trevor Stanley and Chris Ryan

Copyright Notice

This Work is copyright. No part of this Work may be reproduced, stored in a retrieval system, or transmitted in any form or by any means without prior written permission of the Publisher. Except as permitted under the *Copyright Act 1968*, for example any fair dealing for the purposes of private study, research, criticism or review, subject to certain limitations. These limitations include: Restricting the copying to a maximum of one chapter or 10% of this book, whichever is greater; providing an appropriate notice and warning with the copies of the Work disseminated; taking all reasonable steps to limit access to these copies to people authorised to receive these copies; ensuring you hold the appropriate Licences issued by the Copyright Agency Limited ("CAL"), supply a remuneration notice to CAL and pay any required fees. For details of CAL licences and remuneration notices please contact CAL at Level 11, 66 Goulburn Street, Sydney NSW 2000, Tel: (02) 9394 7600, Fax: (02) 9394 7601
Email: info@copyright.com.au
Website: www.copyright.com.au

For product information and technology assistance,
in Australia call **1300 790 853**;
in New Zealand call **0800 449 725**

For permission to use material from this text or product, please email aust.permissions@cengage.com

National Library of Australia Cataloguing-in-Publication Data

A catalogue record for this book is available from the National Library of Australia

Cengage Learning Australia

Level 7, 80 Dorcas Street
South Melbourne, Victoria Australia 3205

For learning solutions, visit cengage.com.au

Printed in China by 1010 Printing International Limited.
1 2 3 4 5 6 7 27 26 25 24 23



CONTENTS

Preface	v
About this series	vi
<hr/>	
Unit 1 Real-world accounting	1
<hr/>	
1 The accounting environment	2
Accounting for business organisations	3
Introduction to accounting	8
Objectives of accounting	10
Forms of business organisations	13
The accounting profession in Australia	16
Factors impacting accounting	19
Chapter revision	23
2 Financial statements	25
Fundamental concepts and principles	26
Accounting equation	28
Statement of Financial Position	32
Fundamental concepts and principles	38
Statement of Profit or Loss	39
Comparison of various accounts for a sole trader and a public company	40
Statement of Cash Flows	40
Chapter revision	45
3 Fundamentals of processing transactions	48
Ledger accounts	49
Summary of rules for recording transactions	60
Preparation of ledger accounts	63
Trial balance	70
Chapter revision	75
4 The accounting process to the trial balance	78
The accounting process	79
Source documents	80
Journal	92
Goods and services tax (GST)	111
Journalising business transactions	119

Accounting for different types of transactions with GST	120
Chapter revision	148
5 Accounting technology	153
A computer system	154
Accounting software	158
Accounting packages	158
An introduction to MYOB AccountRight: general journal entries	164
Accounting packages: control accounts and subsidiary ledgers	169
Accounting packages: inventories	181
MYOB AccountRight accounting package for a trading business with GST using subsidiary ledgers	193
Spreadsheets	204
Business graphics in spreadsheets	213
Chapter revision	218
<hr/>	
Unit 2 Financial reporting	223
<hr/>	
6 End of period reporting	224
Accounting period and profit determination	225
Preparation and presentation of the Statement of Profit or Loss	227
Preparation and presentation of the Statement of Financial Position	230
Preparation of the Bank Reconciliation Statement	234
Preparation and presentation of the Statement of Cash Flows	235
Combined illustrative example of the Statement of Profit or Loss, Statement of Financial Position and Statement of Cash Flows	240
Balance day adjustments	245
The adjusted trial balance and end of year financial statements for a service organisation	254
Preparation of end of year financial statements for a trading organisation	267
Chapter revision	290
7 Internal controls	293
Nature and importance of internal controls	294
Control over credit	297
Control over inventories	311
Credit, inventories, profitability and liquidity	319
Chapter revision	322
8 Performance analysis of a sole trader business	324
Analysis and interpretation of reports	325
Chapter revision	338
Index	342
Chart of accounts	349

PREFACE

Accounting: An Introductory Framework Units 1 & 2, fifth edition, provides a simple yet comprehensive introduction to the discipline of accounting. This new edition contains all of the features that were so liked in the previous editions and shows how accounting operates in the modern world.

Important concepts and procedures are carefully highlighted, and graded questions are fully integrated within the text to ensure a steady development of knowledge and understanding. A large number of fully worked illustrative examples and diagrams are included to assist learning. Many documents have been reproduced so that students will gain an insight into how accounting information is collected, presented and used in real-world businesses. Chapter revisions at the end of each chapter provide multiple-choice and practical questions to enhance student understanding.

The use of technology in accounting is a key feature. Accounting packages and spreadsheets are crucial to the study of accounting and are highlighted and explained in all relevant chapters. Web-based examples and exercises are also included to ensure the use of this technology in researching and analysing accounting information.

To provide flexibility, Chapter 5 'Accounting technology' is a stand-alone introductory chapter. This means that teachers can introduce computer systems, accounting packages, spreadsheets and business graphics to students when they think best. As well, this chapter explores how accounting packages process data using subsidiary ledgers for accounts receivable, accounts payable and perpetual inventories. This provides a conceptual understanding of what happens when the control account/subsidiary ledger technique is used inside the package. This will help students appreciate why control accounts and subsidiary ledgers are used, and in particular with inventories, how cost of goods sold is determined for each sale and the resulting inventory balance.

Real-world applications are also illustrated to highlight the use of accounting in everyday life and in modern business. 'Communication' sections are integrated throughout to assist in the development of language education.

Trevor Stanley
Chris Ryan

ABOUT THIS SERIES

This new edition of *Accounting: An Introductory Framework Units 1 & 2* has been fully updated for the QCAA Accounting General Senior Syllabus implementing Units 1 & 2 in 2025 and Units 3 & 4 in 2026. It comprehensively covers the syllabus and unit objectives using the problem-solving approach valued in the syllabus, with integration of the underpinning factors throughout.

Student book

- Reflects changing terminology, as well as current practices, extensive use of technology (accounting packages, spreadsheets including business graphics, and the Internet) and real-world applications.
- Features chapter revision activities at the end of each chapter and numerous questions throughout to ensure a steady development of knowledge and understanding.
- Updated questions and activities which include the syllabus cognitions to ensure students practise each skill.
- Addition of source documents within questions for students to analyse and interpret.
- Numerous illustrative examples and diagrams are included to assist learning.

CHAPTER 4 THE ACCOUNTING PROCESS TO THE TRIAL BALANCE 79

The accounting process

In Chapter 3, you were shown how to analyse any transaction and deduce its effect on asset, liability, owner's equity, revenue or expense items. You determined what accounts would be debited and what accounts would be credited, posted the transaction to the ledger, and, after all transactions for a period of time were recorded, prepared a trial balance to check the arithmetical accuracy of the records.

In this chapter, we will concentrate on the initial stages of the accounting process. You will realise the importance of source documents and understand the role of the general journal in the recording process.

Accounting records are kept continuously. However, for practical reasons – such as maintaining day-to-day operations, reporting profits and paying taxes – records are balanced and reports are prepared for various time periods. This period could be a week, month, quarter, half-year or year. At a minimum, reports would have to be prepared for each financial year, which for most businesses runs from 1 July to 30 June.

As shown in Figure 4.1, the sequence of events or steps in the accounting process used to record and report information generally is:

- 1 Prepare or collect source documents to verify that transactions have occurred.
- 2 Analyse transactions into their debit and credit elements, and enter onto a journal.
- 3 Post the debit and credit elements to appropriate ledger accounts, and prepare a trial balance.
- 4 Record and post balance day adjustments.
- 5 Prepare end-of-period (month/year) financial reports.
- 6 Record and post closing entries at the end of the year.
- 7 Record and post reversing entries to allow the next yearly cycle of recording to commence.

Figure 4.1 The accounting process

We have already touched on a number of these steps in learning about double entry. Now, in the next few sections, we will gradually go through each of these steps in the accounting process so that you can understand how the process results in accurate and reliable financial reports.

Before we do that, let's touch on some elements that are fundamental to accounting. These include:

- the **accounting entry concept** (discussed in Chapter 2), which separates the owner from the business for accounting purposes. This is vital as we are only accounting for the business and not the owner
- the **monetary principle**, which states that all transactions are recorded in the common monetary unit in use (dollars and cents). Thus, transactions that cannot be quantified in financial terms are not recorded in the financial reports.

CHAPTER 4 THE ACCOUNTING PROCESS TO THE TRIAL BALANCE 148

An entry is now recorded in the general journal to correct the error. Which of the following statements is correct?

14 Which of the following would result in a debit entry to the Inventory account for \$1900?

15 Maudsley Pty Ltd purchased for cash a machine worth \$7000 (including GST). Which of the following is correct?

16 Thom Trading sold goods worth \$3000 to V Young on credit for \$3300 (including GST). Which of the following is correct?

17 Item Trading sold goods worth \$3000 to V Young on credit for \$3300 (including GST). Which of the following is correct?

18 Item Trading sold goods worth \$3000 to V Young on credit for \$3300 (including GST). Which of the following is correct?

19 Item Trading sold goods worth \$3000 to V Young on credit for \$3300 (including GST). Which of the following is correct?

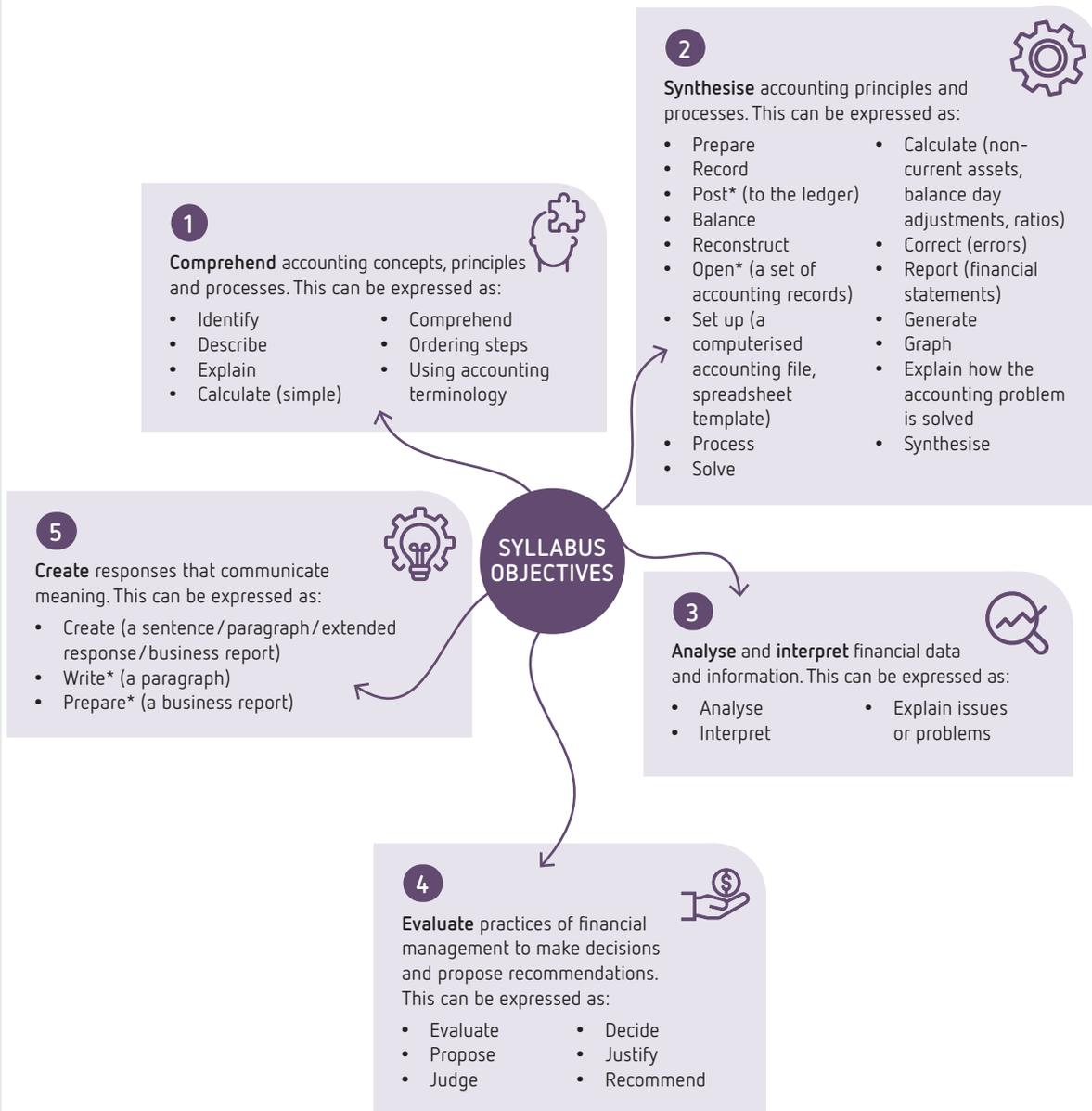
20 Item Trading sold goods worth \$3000 to V Young on credit for \$3300 (including GST). Which of the following is correct?

Using the ledger account below, answer questions 17–20.

Cash at Bank		No 3103	
Apr 1 Capital	G/L 100 000	Apr 1 Motor Vehicle	G/L 20 000
20 Service Fees Revenue	G/L 4 000	1 Equipment	G/L 10 000
22 Service Fees Revenue	G/L 7 000	1 Furniture	G/L 4 000
		2 Rent Expense	G/L 8 000
		3 Advertising	G/L 300
		3 Office Expenses	G/L 200
		4 Cash Investment	G/L 20 000
		1½ Wages	G/L 1 600
		28 Wages	G/L 1 600
		29 Drawings	G/L 3 000
		30 Bank Charges	G/L 10

Cognitions

In Accounting, students will develop a deep understanding of the subject matter through using a range of cognitive processes. These cognitions are defined in the syllabus objectives, which allow them to demonstrate skills to comprehend, synthesise, analyse and interpret, evaluate and create elements of accounting concepts, principles and processes. To assist students in recognising when and how they are developing these skills, the relevant verbs have been bolded in each of the exercises in the book. By the conclusion of Units 1 and 2, students will be able to:



* Commonly used in Accounting and extra verbs to the syllabus.

Source: Queensland Curriculum and Assessment Authority. https://www.qcaa.qld.edu.au/downloads/senior-qce/syllabuses/snr_accounting_25_syll.pdf



An online learning space that provides students with tailored learning experiences*



For students:

- Access weblinks associated with the content to build upon your understanding of the concepts through real-world applications.
- Download individual chapters as PDFs for easy offline access to the material.
- Navigate your own learning path, accessing the content, and support as you need it.

For teachers:

- Access the specifically designed teaching Program.
- Access worked solutions that can be downloaded.
- Help build your students' exam readiness with **Cognero Assess** – a test bank containing hundreds of questions and answers to create, assign or export formative and summative tests.

* Complimentary access to these resources is only available to schools that use this book as part of a class set, book hire or booklist. Not available for single purchases. Alternatively, teacher access can be purchased as a separate subscription for schools. Contact your Cengage learning consultant for information about access and conditions.

Security & privacy:

- Nelson MindTap joined the Safer Technologies 4 Schools (ST4S) Product Badge Program in 2024. The annual ST4S assessment is part of our commitment to supporting the online security and safety of students and schools. Learn more at st4s.edu.au

UNIT

1

REAL-WORLD ACCOUNTING

Introduction

In this first unit you will be introduced to accounting and study its functions and roles. Keeping accounting records and learning how to interpret them is an important part of operating any business or similar organisation. You will see how accounting provides **information for decision making** and helps **evaluate performance**, allowing businesses to operate efficiently and profitably. Indeed, accounting is now so important in our business lives that parts of its terminology have become common in our everyday language. Accounting is thus sometimes called '**the language of business**'. But it is much more than this. You will also see that it can assist all types of organisations, as well as governments and individuals, to manage their financial affairs efficiently.

After this unit you will understand the environment in which accounting operates; what is published in public company financial reports; the basic rules of accounting; how information is recorded and processed; how accounting reports are prepared, analysed and interpreted; and how technology can assist in processing data and information, and making decisions.

1

THE ACCOUNTING ENVIRONMENT

LEARNING OBJECTIVES

At the end of this chapter you should be able to:

- describe the nature and objectives of accounting
- describe the main forms of business organisations that use accounting
- describe where people can invest their money and the main financial statements used in accounting
- explain why investments are made in businesses and how accounting information is used to inform practices of financial management of businesses
- explain the difference between cash and net profit
- analyse the relationships between the main elements of a company's financial statements
- explain the role of the auditor
- explain the nature and role of the accounting profession.

*The accounting environment***Accounting for business organisations**

- Where to invest?
- Statement of Profit or Loss
- Statement of Financial Position
- Statement of Cash Flows
- Illustrative example highlighting financial statements

Introduction to accounting

- Definition of accounting

Objectives of accounting

- Information for decision making
- Discharging accountability
- Evaluating performance

Forms of business organisations

- Sole traders (sole proprietors)
- Partnerships

- Companies
- Non-profit organisations
- Public sector organisations
- Trusts

The accounting profession in Australia

- Role of the auditor

Factors impacting accounting

- Historical development
- Legal factors
- Economic factors
- Technology trends
- Ethical considerations and business conduct
- Demand for diversity of accounting services

Chapter revision

Weblinks:

- Woolworths Limited annual reports (pp. 8 and 22)
- JB Hi-Fi annual reports (p.8)
- Qantas Airways annual reports (p.8)
- Flight Centre annual reports (p.8)
- AASB (p.19)
- Behind the Enron scandal: chronology of a collapse (p.21)
- Journal of Accountancy – Academy Awards (p.21)



 Nelson MindTap

To access resources above, visit
cengage.com.au/nelsonmindtap

Accounting for business organisations

Where to invest?

Imagine you have some money to invest. You may have saved \$50 000, or inherited or borrowed it. You basically have a number of alternatives. Some of these include:

- putting the money in the bank
- putting the money into fixed deposits
- buying a share of a house with a friend
- buying shares in a company
- setting up your own business.

What factors will influence your choice about what to do with the money? Some of the factors you would consider include:

- The return each year you will get on your money. This will be in the form of interest, rent, dividends or profit.
- How much capital gain you will achieve on each alternative. This is the difference between the initial investment amount and the amount you will receive for the item when you sell it.
- How much time will be required in monitoring the investment including ongoing effort on a daily basis.
- Which investments meet your own personal goals. For example, you might only like to invest in businesses in certain industries, such as renewable energy.

Only you can decide which of these factors are important to you and therefore which investment to make. You might decide to run your own business because you see you may get a greater return, and you may be able to control the activities of the business through your own hard work. Whatever you decide, you will still need to know that your money will give you a return, otherwise you will be wasting it.

If you decide to invest your money in a business as an owner, you will require financial information about that business so that you can monitor your investment. Accounting performs that role of providing financial information to its investors, its owners/shareholders and other stakeholders interested in its progress. This is done through financial statements. There are three common financial statements that provide information to assist their users' decision making.

Statement of Profit or Loss

The aim of the Statement of Profit or Loss is to show how the business has performed during the period of time (month, year) that the report covers. To do this the report shows the revenues a business receives and the expenses it incurs in order to earn those revenues. Businesses can earn revenues by selling either goods (trading businesses) or services (service businesses). Some businesses offer a combination of both. For example, a hairdresser might earn revenue from cutting hair (service revenue), but they could also earn revenue from the sale of hair products (trading revenue). The resulting net figure is either a profit or a loss during the period. Every business needs to earn profits to continue to operate. However, it is important to realise that this profit figure does not necessarily mean a business has this amount of cash to finance or expand its operations. This distinction between net profit and cash is important, and will be expanded on as your study of accounting continues.

Statement of Financial Position

The aim of the Statement of Financial Position is to present a snapshot at a point in time of what the business owns/controls (assets), the amounts it owes (liabilities) and the owner's investment (owner's equity). This statement is always at a particular date.

Statement of Cash Flows

The aim of the Statement of Cash Flows is to show where the business obtained cash during the period and how that cash was received. There are three sources and uses for cash during the period:

- 1 Operating activities.** The revenues from the operating activities are the receipts the business receives for performing its services or selling its goods. If we are using the example of an accounting practice, then the receipts would be the monies received for doing the accounting for the clients of the business. The payments for the operating activities are the expenses the business needs to pay for to earn those revenues. Typical examples are the cash paid for the wages and salaries of its employees, and other business expenses such as electricity.
- 2 Investing activities.** Investing activities involve the cash used to purchase the resources (assets) the business needs to operate. Typical examples are the purchase of equipment and office furniture.
- 3 Financing activities.** The business needs to have access to resources if it is to be able to operate. The business can obtain those resources either from owner cash inflows or loans from parties outside the business. Likewise, the business may use cash to make payments to its owners in the form of dividends if it is a company, or to repay loans to outside parties.

This analysis of exactly where a business's cash comes from and how it uses its cash is crucial to any decision making about existing or alternative practices of the financial management of the business.

Illustrative example highlighting financial statements

In order to introduce you to the features of these simplified statements, consider the following information for an accounting practice – Vogel Pty Ltd.

Vogel Pty Ltd		
Statement of Profit or Loss for the year ended 30 June 2026		
	\$	\$
Service revenue		254 400
Expenses		
Salaries and wages expense	61 080	
Rent expense	37 000	
Other expenses	19 000	
Interest expense	<u>1 000</u>	<u>118 080</u>
Profit before income tax		136 320
Income tax expense		<u>76 320</u>
Profit after income tax		<u>\$60 000</u>

Vogel Pty Ltd			
Statement of Financial Position as at 30 June 2026			
	\$	\$	\$
Assets			
Cash	10 000		
Accounts receivable	4 000		
Office equipment	<u>81 000</u>		
<i>Total Assets</i>			95 000
Liabilities			
Accounts payable	1 900		
Interest payable	100		
Bank loan	<u>11 000</u>		
<i>Total Liabilities</i>			<u>13 000</u>
Net assets			<u>\$82 000</u>
Equity			
Share capital			40 000
Retained earnings 1/7/2025		0	
Add profit after tax	60 000		
Dividends paid	<u>(18 000)</u>		
Retained earnings 30/6/2026			<u>42 000</u>
<i>Total Equity</i>			<u>\$82 000</u>

Vogel Pty Ltd		
Statement of Cash Flows for the year ended 30 June 2026		
	\$	\$
Cash flows from operating activities		
<i>Inflows</i>		
Cash receipts from operating activities	250 400	
<i>Outflows</i>		
Cash payments for operating activities	<u>192 400</u>	
Net cash from operating activities		58 000
Cash flows from investing activities		
<i>Outflows</i>		
Office equipment purchases	<u>81 000</u>	
Net cash used in investing activities		(81 000)
Cash flows from financing activities		
<i>Inflows</i>		
Issue of shares	40 000	
Proceeds from bank loan	11 000	
<i>Outflows</i>		
Payment of dividend	<u>(18 000)</u>	
Net cash from financing activities		<u>33 000</u>
Net increase in cash		10 000
Cash at beginning of year		<u>0</u>
Cash at end of year		<u>\$10 000</u>

Statement of Profit or Loss

The purpose of the Statement of Profit or Loss is to report how successful Vogel Pty Ltd has been during the year. A perusal of the report reveals:

- The statement covers the financial year ending 30 June 2026.
- It shows an after-tax profit of \$60 000 for the year. This is often called the **bottom line** of the business. The company itself must pay tax on its profits.
- The profit has occurred because the revenues of \$254 400 are greater than the total expenses (including tax) of \$194 400.
- Outside investors and the owners would look at this statement before deciding whether to invest any more money into the business.

Statement of Financial Position

The purpose of the Statement of Financial Position is to report the assets and liabilities and the net worth of the business at a point in time.

- The statement shows the position at close of business on 30 June 2026.
- It shows total assets of \$95 000 and total liabilities of \$13 000, with the difference of \$82 000 being called net assets.
- Net assets will always equal the equity in the business. This occurs because the funds represented by the net assets will have been contributed by the owners of the business.

- The equity of \$82 000 is what the business is worth to the owners – or, putting it another way, the owners' investment in the business.
- The assets the business owns comprise cash in the bank (\$10 000); amounts owing to it on 30 June by its customers – called accounts receivable (\$4000); and office equipment that has been purchased in order to assist the business to operate (\$81 000).
- The liabilities the business owes are comprised of amounts owing to its suppliers at 30 June (\$1900); interest payable on the loan of \$100; and the principal value of the loan at 30 June (\$11 000).
- The equity, being the investment of the owners in the business, can be seen as comprising two elements: share capital (the value of shares issued) and retained earnings.
- Total share capital at 30 June was \$40 000. This is the amount the shareholders/owners have invested in the business.
- The retained earnings at 30 June 2026 are \$42 000. Note that there were no retained earnings at the beginning of the year (1 July 2025), but these were increased through the profit made during the year of \$60 000 and the dividends paid of \$18 000, giving a figure for retained earnings at 30 June 2026 of \$42 000. The dividends are the return paid to the shareholders for investing in the company.
- The retained earnings of a company will increase or decrease over time depending on what was available in the prior year, and the profits made and dividends paid during the year.

Statement of Cash Flows

The main purpose of the Statement of Cash Flows is to report the cash receipts and cash payments the business made during the reporting period.

- The statement has three sections: cash inflows and outflows from operating activities; cash inflows and outflows from investing activities; and cash inflows and outflows from financing activities.
- The Statement of Cash Flows agrees with the cash at bank figure from the Statement of Financial Position; that is, \$10 000.
- Operating flows: the statement shows operating cash receipts of \$250 400. This is primarily cash received from providing services to customers. The statement shows operating payments of \$192 400. This is primarily cash paid for the expenses necessary to earn the revenues.
- Investing flows: the statement shows an outflow of \$81 000 because the business purchased equipment.
- Financing flows: the statement shows an inflow of \$40 000 cash from the owners because shares were issued, and an inflow from the bank because a loan was taken out for \$11 000. During the period, a financing cash outflow occurred because dividends of \$18 000 were paid out to the owners.

Interrelationships between the statements

The three main reports are interrelated and it is important that these interrelationships are understood when analysing the results of a business for a period of time.

- The profit figure from the Statement of Profit or Loss appears in the Statement of Financial Position as an increase to the equity figure.
- The revenues and expenses from the Statement of Profit or Loss form the basis for the operating section of the Statement of Cash Flows, but are not exactly the same because the Statement of Cash Flows shows flows of cash only. You will see in your further study of accounting that **profit is not cash**. A business can make big profits but have little cash to pay its debts. This is why there is a separate statement devoted to the flows of cash. You can see that Vogel Pty Ltd has made a net profit after tax of \$60 000 but it only has \$10 000 cash in the bank on 30 June 2026.
- The final figure in the Statement of Cash Flows should be the balance of the Cash account listed in the asset section of the Statement of Financial Position.
- The dividends shown in the Statement of Financial Position appear in the financing section of the Statement of Cash Flows.

Check for understanding

- 1.1 **Explain** the purpose of the:
- Statement of Profit or Loss
 - Statement of Financial Position
 - Statement of Cash Flows.
- 1.2 On Nelson MindTap, you will find links to the 2023 annual reports for Woolworths Limited and JB Hi-Fi. Both of these are trading companies; that is, they buy and sell goods for a profit.

Analyse the reports and answer the following questions for **both** companies.

(Hint: you may need to move into the Notes to the Financial Reports to answer some of the questions.)

- What is the after-tax profit for each company?
- How has this after-tax profit been calculated?
- What are the total assets, liabilities and net assets for each company?
- What is the total equity for each company?
- What are the different categories of assets each company has?
- What are the different categories of liabilities each company has?
- What are the components of equity at the end of the financial year?
- What was the amount of cash reported as an asset?
- What was the amount of net cash from operating activities?
- What was the amount of net cash used in investing activities?
- What was the amount of net cash from financing activities?
- How much did the company pay in repayment of borrowings?
- How much did the company receive from customers?
- In 2022, how much did the company receive from customers?

- 1.3 On Nelson MindTap, you will find links to the 2023 annual reports for Qantas Airways and Flight Centre. Both of these are service companies; that is, they earn revenues from providing services rather than selling goods. **Analyse** the reports and answer the questions in 1.2 for both companies.
-



Weblinks
Woolworths
Limited annual
reports

JB Hi-Fi annual
reports



Weblinks
Qantas Airways
annual reports

Flight Centre
annual reports

Introduction to accounting

Accounting affects everyone in a modern society. **Most people** need some simple form of accounting to deal with their personal financial matters: budgeting, paying taxes and so on. **Business firms** need accounting systems to enable them to operate efficiently. Indeed, inadequate accounting records or an inability to interpret and use records are a major cause of many business failures. **Governments** need accounting systems to allow them to account for the very large amounts of money they receive and spend.

In this book we are mainly concerned with the use of accounting by business firms. However, all the principles, and most of the skills to be learnt, can also be applied to personal finances. Similarly, they apply to organisations of any type, no matter whether they are trading or services businesses, or how they process their data.

Definition of accounting

To the person in the street, accounting may mean anything from ‘the best way to run your business affairs’ to ‘the only way of presenting a true and fair view of business affairs’. The accountant may be seen as ‘a colossal bore’ or as ‘a wizard with figures’. None of these views is entirely true.

Accounting is a very complex process and is therefore difficult to define. However, one useful definition is:

Accounting is a discipline that measures, records and processes financial and other information about an entity, and reports and interprets that information to interested parties to enable them to make appropriate decisions.

A definition is a description or explanation of a word or thing, using its attributes, properties or relationships to distinguish it from other things. Therefore, a definition should include:

- the word or phrase being defined
- the place of the item in a broader group to which it is related
- enough information to describe this particular item and to differentiate it from others in the broad group
- an example of the item, or other information about its use.

This definition of accounting highlights the following:

- Accounting is a **discipline** or body of knowledge. It is an extremely important discipline to the wellbeing of any entity – from the individual to the largest organisation. Inadequate accounting records can cause personal hardship and, in the case of business, failure of the enterprise.
- Accounting provides information by **recording, processing** and then **reporting** and **interpreting** business transactions and events. This information is generally measured and expressed in monetary terms.
- Accounting **communicates information to interested parties**, such as owners and managers. Such information can be derived from past records or future forecasts. Using this information, decisions can be made and necessary action taken. The important aspect here is the communication of the information provided by accounting. Once this information has been communicated to individuals in their personal capacity, or to individuals working in business, appropriate decisions can be made. For example, information on cash balances means that appropriate decisions on purchases or investment can be made. As a society, though, we should encourage businesses in their decision making to balance the goal of financial success with social responsibilities.

Figure 1.1 shows how data are processed to provide information to interested parties for use in their decision making.

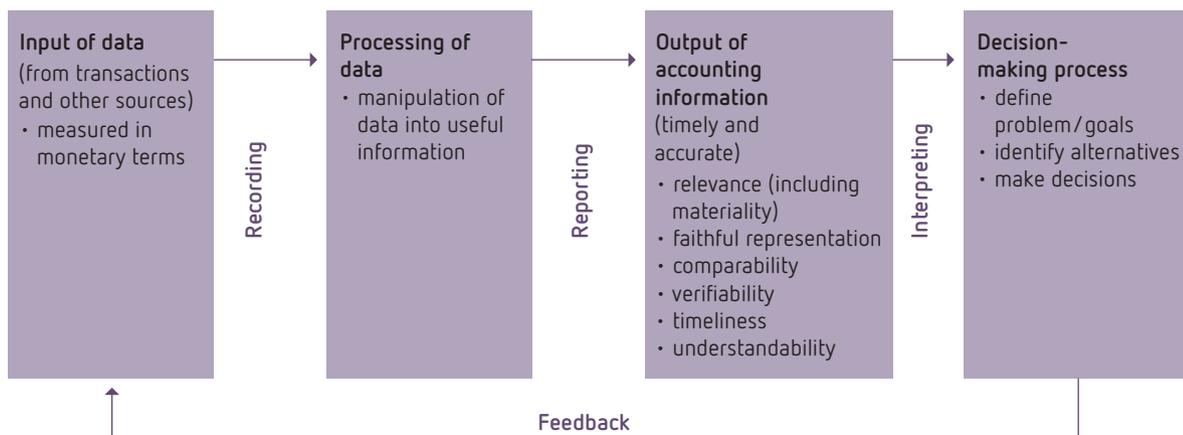


Figure 1.1 How interested parties use accounting information to make decisions

Objectives of accounting

The main aim of accounting is to assist in the **governance of an organisation**. Organisational governance (or corporate governance) is a broad term that refers to the overall management and operational controls in existence within an organisation.

To assist organisational or corporate governance, accounting communicates business and economic information to various interested parties. These interested parties who wish to use accounting information can be classified into two groups: internal users and external users.

- **Internal users** include all levels of management and other governing bodies of an organisation.
 - Management and other governing bodies, such as executives of clubs and boards of directors, are continually making decisions on various aspects of the operation of the organisation, such as financing, personnel, production and marketing.
- **External users** include investors and other resource providers, and government departments and other parties performing a review or oversight function.
 - Investors and other resource providers, such as creditors, lenders, employees and suppliers, are particularly interested in the organisation's performance and financial position. They wish to evaluate how efficiently and profitably management and the organisation as a whole have used the resources entrusted to them. They will be interested in such things as financial stability and returns on investments.
 - Governments and other parties performing a review or oversight function – such as the Australian Taxation Office and the Australian Bureau of Statistics – labour unions, the media and special interest groups (including environmental and consumer groups) are interested in information from the organisation, to see if it is complying with external requirements and meeting social obligations.

The form the communication takes depends on the information to be conveyed and the type of user of the information. Internal users may receive information in the form of emails, memorandums, letters, dashboards, short specific-purpose reports, or more formal accounting reports such as Statements of Profit or Loss and Statements of Financial Position. External users usually receive formal accounting reports, especially Statements of Profit or Loss, Statements of Financial Position and Statements of Cash Flows. These are referred to as general purpose reports. Most accounting reports are comprised of columns of figures. However, accountants now usually add written sections, graphs, tables, photographs, illustrations and so on to make them more readable. Even so, most accounting reports are quite difficult to read and interpret properly, and require some knowledge of accounting and business. Summarising is a useful technique that assists interpretation (see page 12).

What accountants are trying to do in terms of the governance of an organisation can be expressed in three main objectives or functions, which are to:

- provide information for decision making
- assist in discharging accountability
- help evaluate performance.

To achieve these three objectives, information must be provided to users to allow judgements to be made concerning matters such as:

- performance in using resources efficiently
- the financial position or condition of the reporting entity
- financing and investing activities undertaken
- compliance with external requirements, such as the law and government regulations.

Information for decision making

As we have seen, **decisions concerning the efficient acquisition and allocation of economic resources** will be made by all levels in business organisations, and by many individuals and groups in society. Each of these will face varying degrees of uncertainty. Relevant, reliable, cost-efficient and timely information will help to reduce that uncertainty, and allow better decisions to be made.

General purpose reports, such as Statements of Profit or Loss, Statements of Financial Position and Statements of Cash Flows, allow decisions to be made by management and by external users. For example potential investors will make decisions about investing their resources in an organisation based on their estimation of its continued profitability, financial stability and ability to pay good returns on money invested.

Special purpose reports, such as an analysis of sales by product, might point to poorly performing products that could be deleted from a product list, or to high-performing products that warrant expenditure on more production and marketing resources.

Discharging accountability

The second main function of accounting is to assist in discharging accountability. Accountability in general means being **held responsible** to another (usually higher) authority for actions carried out. For accountants, this is translated to mean responsibility to provide information to enable users to make informed judgements about the performance, financial position, investment activities and compliance of the reporting entity.

In practice, this concept refers mainly to the accountability of the **management** or other governing body in meeting their responsibilities to owners in terms of performance, organisational control and other governance issues. Accountability also refers to employees and to the organisation as a whole. All employees are accountable to management. They have responsibilities to do their jobs efficiently and honestly. The organisation is accountable to governments, various other bodies, and even society as a whole. It has responsibilities for meeting legal and other expectations, and in general for having ethical dealings with all those affected by it.

Accounting provides much of the information necessary to allow judgements to be made about whether responsibilities have been met and accountability discharged. Thus, reports will address not only general management accountability for using resources entrusted to them to run the organisation profitably by, for example, making good investment decisions, but also such concerns as the health and safety of employees and the organisation's environmental policy. This is done either in special purpose reports or in specific parts of general purpose reports.

Evaluating performance

The third main function of accounting is to help evaluate performance. **General purpose reports** will allow an evaluation of the performance of management in using resources efficiently, earning profits, achieving financial stability and so on. **Special purpose reports** will allow the performance of individuals and groups within the organisation to be evaluated by management or interested external users. For example, an analysis of sales by salesperson and product would allow the marketing or sales manager to evaluate the performance of salespeople and teams; or an analysis of overdue amounts owing to the organisation might allow judgements to be made about the credit manager and credit department staff.

To aid such evaluations, accounting reports often compare **budgeted** or planned figures with **actual** results, so that exceptions and variations from expectations are highlighted. Performance can then be judged against these expectations or targets. Reports might also be prepared on a comparative basis (i.e. by providing figures for two or more years), to allow comparisons and analysis of trends over time, and to enhance comparisons of performance with competitors and industry averages.

Communication



The key role of an accountant is to synthesise and analyse the relevant financial data and information in order to evaluate a business decision. Effective communication of the results of this evaluation requires a number of skills, including summarising.

Summarising

Purpose

A summary is a brief version in your own words of the main facts and ideas that are addressed in detail in a piece of written or spoken material. Its purpose is to save time or space by conveying only the chief points of the more lengthy original.

How information is communicated

A summary would be written in complete sentences and paragraphs. Important points may be highlighted in bold or with a highlighter. If it is a long piece of material, it may have section headings.

To make a summary you would follow these steps:

- Read or listen to the material carefully, so that you understand the message being conveyed.
- Make notes of what you consider to be the important parts.
- Rewrite the main ideas and points in complete sentences in your own words.
- If necessary, redraft to ensure an appropriate length and to convey the main ideas clearly.

Example

A three-page article from a professional accounting magazine might be summarised down to three paragraphs in the following way:

Skills needed by the modern accountant

A modern accountant must be able to do more than just work with figures. In order to carry out the functions of communicating information to interested parties for decision making, evaluating performance and establishing accountability, accountants must develop all aspects of their *language and communication skills*.

They must be good at both collecting and presenting information. They must select appropriate information, then carefully consider their audience and the purpose of the communication in order to decide on an appropriate form. Sometimes, as in the case of a client–consultant situation, *oral communication skills* may be necessary. In other situations, *written communication* in the form of a memorandum, letter or written report may be more appropriate.

In addition, many circumstances require accountants to *work as part of a team*, and within agreed timeframes, to help achieve organisational objectives. This means that modern accountants will also need *interpersonal skills*, such as active listening, negotiation and persuasion, as well as skills in *time management*.

Check for understanding

- 1.4 Find two definitions of accounting from other sources. **Explain** the ways in which these definitions are similar and the ways they differ from the one in this book.
 - 1.5 Accounting has a number of objectives that assist with corporate or organisational governance. **Describe** and **explain** these.
 - 1.6 ‘The basic objective of accounting is to provide information that will assist in decision making.’ **Analyse** this statement with reference to the people who make decisions and the kinds of decisions made.
-

Communication



Note taking

Purpose

Notes are used to record information and relationships from written or spoken material, and from observed data. They assist with research, aid memory, enable quick and easy reference for later tasks or tests, and can be used to communicate to other parties.

How information is communicated

Outline notes are the most common type of note. They are brief, structured notes in point form, with the main ideas or points listed closest to the left margin and related points indented below, one to a line. They can be handwritten or prepared on a computer for easy editing and additions.

Here are some points to help you record good outline notes:

- Remember to copy down all bibliographic details of your source – author, title, place of publication, publisher and year of publication.
- Survey or skim read to understand the pattern of ideas and to select relevant paragraphs.
- Rule a wide margin or leave space to record page numbers or other supportive references, or to note aspects to be explored further.
- Use the main headings in the material as your headings, then select key sentences with the central idea from each paragraph to become subheadings.
- Use other sentences in the paragraph to provide examples, and related points and ideas, to be listed down the page, one idea per line.
- Use appropriate abbreviations to save time.

Forms of business organisations

Although accounting can be used by many different people and organisations, this book focuses mainly on how it is used in business organisations. There are many ways of classifying business organisations. One way is according to the type of activity they engage in – retail, service or manufacturing, for example. Another useful method of classification from an accounting point of view is by ownership type. The main types of business ownership are sole traders (sole proprietors), partnerships and companies.

Sole traders (sole proprietors)

A sole trader is a one-person business where the one owner supplies most of the funds to commence the business, runs the business, is responsible for its debts, and takes all the profits and bears all the losses.

Although it is regarded as a separate accounting entity under the accounting entity assumption (which states that the business is accounted for separately from the owner, see page 27), the business is not regarded as a separate legal entity. Thus the owner's private possessions may be sold to pay the debts of the business, and the owner is therefore said to have **unlimited liability**. Sole traders may work in the business by themselves or may employ workers.

The popularity of this type of business enterprise no doubt stems from the fact that the owner is his or her own boss. The growth of the business is limited by the owner's personal wealth and capacity to raise funds and, unless this is considerable, it usually places limits on the business's ability to grow. The type of business conducted is limited by the following:

- **Law:** A sole trader cannot operate a bank, a building society or an insurance firm.
- **Licence:** It is necessary to obtain a licence to engage in certain types of business activities, such as running a taxi service or a hotel.
- **Qualifications:** Certain professions require the possession of suitable qualifications before their practice can be commenced, such as doctors, lawyers, dentists, pharmacists and accountants.

A further requirement is that if the owner does not operate the business under his or her own name, the business name must be registered before the sole trader can commence operations. For example, if Giorgio Salvatore wished to open a pizza delivery business and trade as Salvatore's Pizza, then this business name would need to be registered. However, if he wished to trade as Giorgio Salvatore, this would not require registration, as it is his own name.

Businesses not affected by the above restrictions can be commenced by a sole trader without official permission or legal formalities. Because it is not a separate legal entity, the business is not subject to tax, but the owner must pay tax on the business's profits.

Partnerships

A partnership is formed when two or more people (usually not more than 20) join to operate a business. The business is not regarded as a separate legal entity. Thus, the owners are jointly liable for the debts of the business, and their personal possessions may be sold to pay for such debts. Like sole traders, each partner is said to have **unlimited liability**. The *Partnership Act 1891*, or an agreement drawn up between the partners, governs the way in which the partnership will operate and be managed, and how responsibilities and profits will be shared. A partnership does not pay tax but must complete a tax return, and the tax is paid by the individual partners.

Companies

Companies are bodies formed to overcome the disadvantages of the sole trader and partnership forms of business organisation. In general, such organisations are controlled by the various requirements of the *Corporations Act 2001*. Companies registered under the Corporations Act are regulated by the Australian Securities and Investment Commission (ASIC), which is an independent government body. Although they can be formed with only one shareholder, companies usually have a larger number of owners or shareholders who, by law, are regarded as separate from the company. The company is a separate legal body and is responsible for all its debts. The owners of companies are called shareholders. Shareholders are said to have **limited liability** because they are liable for the debts of the business only to the extent of the amounts unpaid on their shares. This means their personal possessions are safeguarded to the extent of this limit if the company should amass debts it is unable to meet. The shareholders are entitled to a share of profits, as a return on money invested, called a dividend.

Two of the more common types of companies are proprietary companies and public companies. Proprietary (or private) companies are often family concerns and, under the Corporations Act, must be distinguished by the words 'Proprietary Limited' (or 'Pty Ltd') after their name. Public companies invite ownership, and obtain share capital and loans, from members of the public. They thus have the potential to be very large business organisations. They have the word 'Limited' (or 'Ltd') after their name. As they are separate legal entities, companies pay tax in their own right at the company tax rate. Proprietary and public companies have different reporting requirements. Aboriginal and Torres Strait Islander groups may wish to become corporations and therefore separate legal entities. If so, they can incorporate under the *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (CATSI Act). Organisations registered under this Commonwealth Act are regulated by the Office of the Registrar of Indigenous Corporations (ORIC).

Non-profit organisations

Sole traders, partnerships and companies usually exist to make a profit. Non-profit (or not-for-profit) organisations are organisations whose primary motive is to provide a focus on and services for people with common interests (e.g. religious, sporting or recreational), or to carry out charity work. The Australian Charities and Not-for-profits Commission (ACNC) is the independent regulator of charities. Charities registered with the ACNC must meet the reporting requirements of the *Australian Charities and Not-for-profits Commission Act 2012*.

Public sector organisations

Public sector organisations do not exist for the purpose of making a profit, but to provide the citizens of the country with various services. These organisations operate at the federal, state and local levels, providing transport, power and other public services to the community.

Trusts

A trust is a legal arrangement whereby assets such as money and property are transferred to the control of trustees to administer for the benefit of **beneficiaries**. The trustees control the assets. The beneficiaries benefit from the assets but cannot control them. Property trusts and unit share trusts allow the pooling of large amounts of funds for investment purposes and control by specialist managers.

In this text we concentrate mainly on accounting for sole traders, but will also touch on partnerships and companies. We will give most attention to organisations that engage in trading and service activities.

Check for understanding

- 1.7 **Explain** the meaning of the term 'unlimited liability'.
 - 1.8 **Describe** the main types of business ownership, mentioning the advantages and disadvantages of each type.
-

Communication



Paragraphs

Purpose

The purpose of a paragraph is to convey an idea or concept.

How information is communicated

A paragraph should have a topic sentence with the key concept of that paragraph. The supporting sentences in the paragraph should relate to this key concept and develop the explanation of the concept, providing some examples and illustrations. The final sentences conclude or summarise the explanation of the key concept. However, if there is more than one paragraph, this conclusion may be contained in the final sentence.

Example

A paragraph on the nature of the Statement of Financial Position might read as follows:

The purpose of a Statement of Financial Position is to list the assets, liabilities and owner's equity of an organisation in order to show the financial position at a particular point in time. It can be presented in either a narrative or T account format. The Statement of Financial Position is a more detailed expression of the accounting equation, giving details of particular assets, liabilities and owner's equity. As a result, it is of particular importance to all parties interested in the assessment of the net worth of the business.

The accounting profession in Australia

Accountants now have a wide variety of career paths open to them. They can be employed by private businesses, as accountants or financial controllers; or they can work as public accountants, providing independent professional services to the public, as auditors, advisors, tax accountants and so on; or in government and institutional bodies, preparing reports and ensuring that laws and regulations are followed. The role of the accountant has changed and will continue to change because of technological advances and the emergence of new areas of specialisation.

Some of the more common areas of specialisation are:

- cost accounting
- government accounting
- taxation
- budgeting
- company accounting
- e-business
- insolvency
- financial planning
- international accounting
- management advisory services
- forensic accounting
- auditing
- design of accounting/information systems
- finance.

As with most professions, the accounting profession has associations that exist for its advancement and for the benefit of its members. In Australia, the three largest associations are:

- CPA Australia
- Chartered Accountants Australia and New Zealand (CA ANZ)
- Institute of Public Accountants (IPA).

One of the main tasks of professional associations is to set standards of performance and ethical conduct for their members. They also represent accountants in negotiations and consultations with other bodies.

Professional accounting associations have entry qualifications, and aim to keep their members up to date with new developments by producing journals and offering professional development seminars. They also make pronouncements on what is considered to be good accounting practice, and accountants who are members of these professional bodies are expected to abide by them. Consequently, these pronouncements have had a significant effect on the development of accounting.

Pronouncements take a number of forms. The main form is Accounting Standards.

Accounting Standards are set by the Australian Accounting Standards Board (AASB), under the oversight of the Financial Reporting Council (FRC). On 1 January 2005, Australia adopted International Financial Reporting Standards (IFRS), which the AASB renumbered according to the Australian numbering system. There is a view that the adoption of international accounting standards facilitates the flow of capital across national borders, benefiting both investors and companies. Some of the common Accounting Standards are:

- AASB 101 Presentation of Financial Statements
- AASB 102 Inventories
- AASB 107 Statement of Cash Flows
- AASB 116 Property, Plant and Equipment.

Accounting practice and reporting are also heavily influenced by requirements of the Corporations Act, ASIC and the Australian Securities Exchange.

Role of the auditor

An auditor is an accountant who is registered to perform company audits. There are two types of auditors who perform different roles in organisations: an internal auditor and an external auditor.

An **internal auditor** is employed by the organisation to ensure that correct processes are being followed within it. Most large organisations would have internal auditors.

The more common type of auditor is an **external auditor**.

An external auditor is an independent person who is called upon to express an opinion that a company's financial reports provide a 'true and fair' representation of its financial status.

The auditor provides a report to the company's shareholders. The audit report:

- states the company being audited and the period for which the audit occurred
- states if the financial reports are in accordance with the Corporations Act and relevant accounting standards
- contains an opinion that the auditor is satisfied that the financial statements present fairly the results of operations and cash flows and the financial position
- states that the auditor has met the standards of being independent from the company being audited.

In most instances a clean audit report is the norm. The reason for this is that if the auditor has any major concerns, he or she will usually take these matters up with the management of the organisation before issuing their report, thus providing an opportunity for management to rectify any major issues.

The purpose of an external audit is to add credibility to the reports presented by the directors of the company to the shareholders.

Communication



Research

Purpose

The verb 'to research' means to investigate or enquire in order to gather or discover data and information to apply to some task or problem. Such a task might be to write a report or an assignment, or to prepare for an examination.

Sometimes the research topic or question is provided for you. Sometimes you must choose your own.

How information is communicated

How research is communicated will vary according to the purpose or task. This might require a formal written report to be prepared from research notes. It might require an oral report, supported by data on slides or a brief handout. Or it could require only outline notes to be used for later reference and examination preparation.

These are the usual steps involved in research:

- **Plan the task.** Ensure that you know exactly what you need to research. Consider all possible sources of information or data, including library materials, interviews and onsite observation, and fact finding.
- **Gather the information.** This would usually take the form of notes, quotes and statistics, with accompanying bibliographic details of sources.
- **Evaluate the material collected.** Judge its validity, and try to ensure that it will enable you to answer the question or carry out the task required.
- **Write a draft of your answer from your notes.** This would normally be planned in outline form, then expanded into proper sentences and paragraphs, designed to satisfy the requirements of the audience and purpose intended.
- **Prepare a final draft.** Ensure that you use appropriate layout, spelling, grammar, terminology and so on. To enhance your presentation, include any necessary graphical material, statistics and appendices, and a bibliography.

Check for understanding

- 1.9 a **Explain** the aim of an audit report.
 b **Describe** the contents of a typical audit report.
- 1.10 It is often said that there is an 'expectation gap' in auditing. An expectation gap is the difference between the roles that an auditor performs and what the shareholders expect of an auditor. **Create** a paragraph on the role of the external auditor.

Real-world application



The 'big four'

Public accountants work on a fee-for-service basis with a variety of clients, mainly preparing income tax returns and providing financial and other business advice. To be a Certified Practising Accountant (CPA) or a Chartered Accountant (CA) they must pass examinations and have the required amounts of experience in accounting. The 'big four' firms in this area of public accounting and consulting in Australia are:

- Deloitte
- Ernst & Young (EY)
- KPMG
- PricewaterhouseCoopers (PwC).

Most of these firms are established as partnerships. While partnerships in most business areas can have only 20 members, partnerships in areas such as accounting and banking can have up to 100 partners. In recent times there has been a movement towards mergers, amalgamations and takeovers of accounting firms, so the biggest firms in the industry are becoming even larger and more global in nature.

- 1.11 Create a short paragraph on the accounting profession. Name the main accounting bodies in Australia, the entry qualifications required to join them and the publications they produce.
- 1.12 Go to the AASB website and analyse current media releases, lists of standards, current exposure drafts, and any interesting points you find in other sections.



Weblink
AASB

Factors impacting accounting

As accounting is used to communicate financial and other information to interested parties, it is vital that the profession keeps pace with the needs of those it serves. Accountants and accounting do not operate in a vacuum. The business environment is constantly changing, and accounting policies and practice must change also.

Historical development

Accounting is a very old profession and was well known to the early civilisations of the Egyptians, Greeks and Romans. In its earliest form, accounting performed a **stewardship function**; that is, it was concerned with protecting the owner's interests through the collection of business facts and figures. After the fall of the Roman Empire, accounting, along with the other arts, suffered due to the decline in international trade. However, the re-emergence of the arts and international trade during the Renaissance period, around the fourteenth century, brought with it a major development in accounting – the double-entry bookkeeping system. Double-entry bookkeeping is considered to date from at least 150 years prior to 1494, the year in which Luca Pacioli, a Franciscan monk, published the first printed work on mathematics. It included a section on double-entry bookkeeping and commercial practice in Venice at that time. The first known use of double-entry bookkeeping appears to have been in the Genoa Commune Accounts of 1340. Some authors report the existence of evidence that bookkeeping was known and practised prior to that date. Financial statements made an appearance in the fifteenth century when the Medici Bank in Florence required its branches to prepare balance sheets on an annual basis.

The Industrial Revolution, from the mid-eighteenth century, provided the impetus for far-reaching changes that have taken place in the organisation and form of business ownership. Organisations required more capital to finance the large amount of machinery and equipment needed for increased production, and the form of ownership therefore changed from individual to collective.

These changes resulted in larger organisations and the advent of **companies** as a form of business organisation. The increase in collective ownership meant that legislation had to be enacted to protect investors. This led accounting to adapt and add to its stewardship function. Accountants were now required to report information to shareholders and other parties outside the business. Such accounting, which results in the presentation of reports to external users, is called **financial accounting**.

The increase in the size of organisations also made it impossible for management to keep in touch with all that was going on – hence the ‘managerial role’ of the accountant evolved. It became extremely important for the accountant to give management information about the firm to aid them in their decision-making, planning and control processes. Such accounting is called **managerial accounting**.

Legal factors

Government agencies play a role in accounting regulation. Their influence can be seen through the Corporations Act (administered by ASIC), tax law, partnership law and other relevant legislation. Under the law, accountants must also adhere strictly to good practices as set out in various Accounting Standards, some of which are listed on page 17.

Economic factors

We have already seen that the main purpose of accounting is to supply information to interested parties to enable them to make economic decisions. Regardless of whether the information is being supplied to management or to those outside the firm, the accountant must be able to interpret the information in light of economic trends to enable wise decisions to be made. Economic factors and trends to be taken into account include the value of the dollar, supply and demand, and government policies. For example, an accountant in an export-oriented industry would have to consider commodity prices, exchange rates, interest rates and other relevant items.

Technology trends

Many advances are currently being made in technology to speed up the accounting process, reduce cost, and add reliability and accuracy. In addition, technology is having a marked impact on particular aspects of accounting. The introduction of scanners has enabled better inventory control to occur. Computer packages and the use of other software packages, such as spreadsheets and databases, have revolutionised the way accounting is practised. Electronic business has revolutionised the way many businesses communicate and do business with each other and consumers. Further marked developments in this field will occur in the future.

Ethical considerations and business conduct

In recent times, some businesses and entrepreneurs, both in Australia and overseas, have fallen into disrepute for unethical conduct and practices. Such conduct and practices have sometimes resulted in an inflation of reported profits, a reduction of taxes paid to governments, and large losses to creditors and shareholders. The accounting profession, through its accounting and auditing standards, can play a large part in helping to stop such practices and rid business of a largely undeserved reputation.

In addition to helping ensure the ethical conduct of business people, accountants themselves have their own code of ethics. In all responsible professions there is a code of ethics that members are expected to follow. Both CPA Australia and the CA ANZ will expel members for ethical breaches. The code of ethics includes such matters as dealing honestly with all parties, not making use of information gained from clients for personal gain and not breaching the confidence of clients.

Real-world application



Business ethics – the case of Enron

Enron was a US energy trader that misrepresented its value to shareholders over several years. It collapsed in December 2001 with USD63.4 billion in investments. It was the largest bankruptcy in US history. Employees were sent to prison and its accounting firm, Arthur Andersen, one of the world's largest, collapsed.

To learn more, read the *Time* article, 'Behind the Enron scandal: chronology of a collapse'.



Weblink
Behind the Enron scandal: chronology of a collapse

Demand for diversity of accounting services

Accountants now offer a great diversity of services to individuals, as well as small and large businesses. They do this through direct employment, auditing and taxation work, and a range of consultancy and advisory services. Accounting services have expanded and become better tailored to particular segments of business and society. There are now firms that specialise in providing services to governments, retirees, the rural sector and other specific-interest groups.

Interesting accounting fact

Did you know?

Accountants play a prominent role in the Academy Awards

Every year since 1935, a group of CPAs from a major accounting firm count and verify by hand the Academy Awards ballots. They are also responsible for safeguarding the ballots and keeping the results top secret until the winners are announced.

The CPAs used to hand-deliver the envelopes containing the names of the winners on stage in front of the cameras, but this is now done offstage.

What is the name of the accounting firm used by the Academy?



Weblink
Journal of Accountancy – Academy Awards

Check for understanding

- 1.13** Create a paragraph explaining the factors that have significantly affected the development of accounting.
- 1.14** In Australia there are millions of people who have invested in shares in public companies. To provide them with information and assist them with decisions about their investments, companies are required to send reports to shareholders on a regular basis. On Nelson MindTap, you will find a link to the annual reports section of one of Australia's largest public companies, Woolworths Limited. Woolworths is a leading retail company, which had over 24.5 million customers served every week, 200 364 team members and 1463 stores throughout Australia and New Zealand in 2023. These reports provide details concerning results for the company itself (the accounting entity) and for the consolidated group (the company plus other companies/subsidiaries it controls). At the end of appropriate chapters, we will provide you with some questions and activities that will help you analyse and understand these reports.



Weblink
Woolworths
Limited annual
reports

Follow the weblink to the annual reports for Woolworths Limited.

Analyse the annual report for Woolworths Limited for 2023 and answer the following questions.

- a** How many sections are there in the annual report of Woolworths Limited? Name and describe the contents of each section.
 - b** For what period of time is this report presented?
 - c** What people other than shareholders would be interested in the information in the report?
 - d** What activities does Woolworths engage in?
 - e** What is the role of the Board of Directors?
 - f** What does the report have to say about 'corporate governance'?
 - g** Did Woolworths achieve well in the 2022/2023 year? Give some examples to support your answer.
-

CHAPTER REVISION

1.15 Multiple choice

Complete the following multiple-choice questions by choosing the best answer.

- 1 'Accountability' refers to:
 - A being held responsible to another authority for actions carried out
 - B keeping a record of all money that has gone out of an organisation
 - C the communication of information to various parties
 - D the form that communication takes; for example, graphs.
- 2 Creditors are interested in accounting information because:
 - A they wish to keep a close watch on the business's financial stability
 - B they wish to decide whether or not they will receive their money
 - C they wish to decide whether to extend credit facilities
 - D all of the above.
- 3 Which of the following statements is incorrect?
 - A Accounting is a discipline or body of knowledge.
 - B Accounting will stop businesses from failing.
 - C Accounting provides information to interested parties.
 - D Accounting records, processes, reports and interprets information.
- 4 Which of the following factors will influence the future development of accounting?
 - A Legal factors
 - B Technology trends
 - C Social expectations
 - D All of the above
- 5 Which of the following types of business organisations usually have limited liability for debts?
 - A Sole traders
 - B Partnerships
 - C Public companies
 - D All of the above
- 6 The Statement of Financial Position:
 - A shows the cash that the business received during the period
 - B shows the assets, liabilities and owner's equity of the business at a point in time
 - C shows the financial stability of the business at a point in time
 - D shows the financial performance of the business at a point in time.
- 7 The audit report:
 - A states if the financial reports are in accordance with the *Corporations Act 2001* and relevant accounting standards
 - B contains an opinion that the auditor is satisfied that the financial statements present fairly the results of operations and cash flows and the financial position
 - C states that the auditor has met the standards of being independent from the company being audited
 - D all of the above.
- 8 Which of the following statements is correct?
 - A The Statement of Cash Flows shows the cash flows from operating activities during the period.
 - B The Statement of Cash Flows shows the cash flows used in investing activities during the period.
 - C The Statement of Cash Flows shows the cash flows used in financing activities during the period.
 - D All of the above.
- 9 The Statement of Profit or Loss shows:
 - A the equity for the period
 - B the revenues and expenses for the period
 - C the assets purchased during the period
 - D new loans acquired during the period.

- 10 Which of the following statements is correct?
- A An external auditor is an employee of the business.
 - B Dividends paid by a business are shown in the Statement of Profit or Loss.
 - C Net assets will always equal the equity of the business.
 - D The profit figure from the Statement of Profit or Loss appears in the Statement of Financial Position as a decrease to the equity figure.
-

1.16 Research case study

You are approached by 10 entrepreneurial Aboriginal artists from three different states in Australia. They are all studio potters who use clay as their medium to portray ancient Aboriginal customs in their work. They are in regular communication with each other and want to use their art to advance an understanding of their history. They wish to form a group to promote their specific genre of work. Research the potential business structures open to them and provide advantages and disadvantages of each, with a recommendation as to the most appropriate structure. Note: there are other business structures than those discussed in this book.

2

FINANCIAL STATEMENTS

LEARNING OBJECTIVES

At the end of this chapter you should be able to:

- describe the terms assets, liabilities, owner's/share equity, expenses and revenues
- explain the accounting equation, and show how the rules of accounting are developed from this equation
- analyse a simple Statement of Profit or Loss, Statement of Financial Position and Statement of Cash Flows
- create responses that interpret financial results for owners and other stakeholders.

*Financial statements***Fundamental concepts and principles**

- Assets
- Liabilities
- Owner's equity

Accounting equation

- Detailed examination of the equation

Statement of Financial Position

- Changes in the Statement of Financial Position as a result of transactions

Fundamental concepts and principles

- Revenues
- Expenses

Statement of Profit or Loss**Comparison of various accounts for a sole trader and a public company****Statement of Cash Flows**

- The nature of cash and cash flows

Chapter revision**Weblinks:**

- Woolworths annual report (p. 44)
- Qantas annual report (p. 44)
- Flight Centre annual report (p. 44)
- JB Hi-Fi annual report (p. 44)



To access resources above, visit
cengage.com.au/nelsonmindtap



Fundamental concepts and principles

This chapter begins with some key concepts that you need to know in order to understand accounting.

Assets

What are some examples of items that you own or whose use you control? You might own clothes, a computer, a bicycle, some books and money in the bank. These items are known as assets.

Assets are items of value owned or controlled by a business.¹

Businesses also have assets. These assets provide a future economic benefit to the business. Typically these include:

- long-term assets such as vehicles, furniture, equipment, buildings and land
- the cash they have in the bank
- money owed to them by customers for the sale of goods or the provision of services (called accounts receivable or debtors)
- inventories or stock, which are the terms normally given to goods held for sale in the ordinary course of the business. These items are bought with the intention of reselling them at a profit in the future
- supplies, which consist of materials that will be used up or consumed in the rendering of services; for example, a plumber may have supplies of washers, glues, taps, pipes and screws; and a doctor may have supplies of bandages, ointments and gloves. These items are bought with the intention that they will be used in the performance of a service.

Businesses try to increase the number and value of their assets because it is the assets they have built up in the past that provide profits and benefits in the future.

Check for understanding

- 2.1 **Create** a paragraph describing the assets you own and why you consider them assets.
 - 2.2 List the assets you think a grocery business and a used car business might own or control. Notice the difference in the assets of these businesses. **Explain** why they have different assets.
-

Liabilities

As well as owning items, both individuals and businesses have obligations or owe amounts to others, which must be repaid at some future time. For example, you may owe someone money or owe money on an iPad you have bought. These amounts owed are called liabilities.

Liabilities are amounts owed by a business to external parties.²

1 The definitions of key terms used here are best for our purposes. However, the formal definitions of these terms come from the Australian Accounting Standards Board (AASB) document *Conceptual Framework for Financial Reporting* (CFFR): 'An asset is a present economic resource controlled by the entity as a result of past events.' (Extract from Australian Accounting Standards Board, *Conceptual Framework for Financial Reporting* (2020, par 4.3, p23): https://www.aasb.gov.au/admin/file/content105/c9/Conceptual_Framework_05-19.pdf)

'A liability is a present obligation of the entity to transfer an economic resource as a result of past events.' (Extract from Australian Accounting Standards Board, *Conceptual Framework for Financial Reporting* (2020, par 4.26, p26): https://www.aasb.gov.au/admin/file/content105/c9/Conceptual_Framework_05-19.pdf).

2 See footnote 1.

A business also has liabilities. Typically it will owe money to people because it has bought goods (inventories) or services on credit from them (called accounts payable or creditors). It may have taken out a loan from a finance company. This is also a liability. Similarly, if a business has a loan secured by a mortgage over its property, this too is a liability. The business will have to sacrifice benefits and profits to pay these amounts sometime in the future.

Check for understanding

- 2.3 **Create** a paragraph describing any liabilities you have, and why you consider these amounts liabilities.
- 2.4 List all the liabilities you think a grocery business might have. **Explain** if a car business might have different liabilities.
-

Owner's equity

Once you have made a list of all your assets and liabilities you can calculate 'what you are worth' by subtracting your liabilities from your assets.

Similarly, an owner of a business can calculate what his or her interest or investment in the business is worth by deducting the business's liabilities from its assets. This is called owner's equity, or proprietorship.

Owner's equity is the difference between the assets and liabilities of a business, and equals the amount of the owner's interest or investment in the business.³

This concept of owner's equity occurs because the accounting entity concept regards the business as being an entity or body separate from the owners. As accountants, we record transactions from the viewpoint of the business and treat the owners as outsiders. Thus the business is the accounting entity. We keep the books of the business, not of the owners.

The accounting entity concept separates the owner from the business for accounting purposes.

However, the accounting entity may not always be the same as the legal entity; that is, the body which the law recognises as being responsible for the debts and actions of the business. Remember that sole traders have unlimited liability for their business's debts, and the owner may be sued and lose personal assets if the business has insufficient assets to meet its liabilities.

It should be noted that owner's equity is really a liability in that it is an amount of money owed by the business, but it is owed to a 'special' person – the owner or proprietor – and hence is called owner's equity.

We have said four things about owner's equity so far:

- It exists because of the application of the accounting entity concept.
- It is the difference between assets and liabilities.
- It is the owner's investment in the business.
- It is the amount owed by the business to the owner.

³ 'Equity is the residual interest in the assets of the entity after deducting all its liabilities' (Extract from Australian Accounting Standards Board, *Conceptual Framework for Financial Reporting* (2020, para 4.63, p28): https://www.aasb.gov.au/admin/file/content105/c9/Conceptual_Framework_05-19.pdf).

Check for understanding

- 2.5 In your own words, **describe** 'owner's equity'. Remember to refer back to the points on the attributes of a good definition in Chapter 1.
- 2.6 **Describe** the accounting entity concept and its importance in accounting.
- 2.7 **Identify** whether the following items are assets, liabilities or owner's equity:
- | | |
|------------------------------------|---------------------------------|
| a accounts payable (creditors) | h loan to J Jones |
| b loan from bank | i loan secured by mortgage |
| c owner's interest in the business | j motor vehicle |
| d bank overdraft | k accounts receivable (debtors) |
| e furniture | l inventories (stock) |
| f J Chen (an account receivable) | m supplies |
| g cash at bank | n land. |
-

Accounting equation

Keeping in mind that the accounting entity concept regards the business as separate and distinct from the owners and other outside parties, and that as accountants we account from the point of view of the business, consider the following:

- a The owner, T Pollak, introduced \$10 000 cash into the business as owner's equity in order to start the business. If this is analysed from the viewpoint of the business, the business now has an asset – \$10 000 cash at bank. It also has that special type of liability we mentioned before – a \$10 000 debt to the owner. (You will remember that a debt to the owner is an owner's equity item. It would be called capital.)

It can be seen that:

$$\text{Cash at bank } (\$10\,000) = \text{Capital } (\$10\,000)$$

Assets = Owner's equity

Now consider another case:

- b The owner, J Bowen, wants to start a business but has no funds of her own. The business borrows \$10 000 from the bank. Thus the business has \$10 000 cash and a \$10 000 loan from the bank:
Cash at bank (\$10 000) = Loan from bank (\$10 000)

Assets = Liabilities

A more difficult case:

- c J Graham has \$20 000 cash to invest in the business as capital. In addition, the business borrows another \$20 000 from Asco Finance Co. With this \$40 000, the business buys \$1000 worth of supplies, \$14 000 worth of furniture, a \$15 000 motor vehicle, and leaves the remaining \$10 000 in cash.

The business therefore has:

Assets		\$	\$
Cash at Bank	10 000		
Supplies	1 000		
Furniture	14 000		
Motor Vehicle	<u>15 000</u>		
			<u>\$40 000</u>
Liabilities			
Loan from Asco Finance Co	20 000		
Owner's equity			
Capital – J Graham	<u>20 000</u>		
			<u>\$40 000</u>

$$\text{Assets} = \text{Liabilities} + \text{Owner's equity}$$

This relationship between the total assets, total liabilities and total owner's equity of a business is called the accounting equation.

The accounting equation is the relationship between the total assets, liabilities and owner's equity of a business at a certain date. This relationship is always an equality.

The equation is usually expressed as $A = L + OE$

The accounting equation may also be rearranged mathematically as:

$$OE = A - L$$

$$L = A - OE$$

Check for understanding

2.8 **Analyse** the following assets and liabilities for M Rode. **Calculate** the investment in the business.

	\$
Cash in hand	1 000
Loan from bank	4 000
Accounts payable	500
Accounts receivable	9 500
Supplies	500
Furniture	3 500

2.9 Analyse the following items for C Black, a plumber. Use the accounting equation to determine the total value of assets.

	\$
Amount owing to Tim McLean	1 000
Value of pipes held	8 000
Loan from bank	1 000
Amount owing by Charles Frey	1 000
New equipment purchased	3 000
Value of vehicle	15 000
C Black's investment in the business	25 000

2.10 Calculate the missing amount in each of the following accounting equations. An example is given.

Assets	=	Liabilities	+	Owner's equity
\$1 000	=	\$600	+	? (Answer is \$400)
a \$2 000	=	?	+	\$1 800
b ?	=	\$400	+	\$900
c \$3 700	=	\$500	+	?
d \$4 800	=	?	+	\$3 000
e ?	=	\$200	+	\$950
f \$1 200	=	\$550	+	?
g \$2 800	=	?	+	\$1 900
h ?	=	\$1 750	+	\$7 280

2.11 Analyse the assets and liabilities of B Lake, as shown below.

- a** Determine the owner's investment in the business.
- b** State the accounting equation for B Lake's business.

Assets	\$	Liabilities	\$
Cash at Bank	1 000	Accounts Payable	250
Accounts Receivable	500		
Inventories	750		
Equipment	3 000		

Detailed examination of the equation

We have discovered through examination of examples that the accounting equation is $A = L + OE$. Why does this equation hold? Why must it always be an equality?

The equation shows the relationship between the sources of funds and the uses or forms those funds take.

Forms funds take (Uses of funds)	=	Sources of funds	
<ul style="list-style-type: none"> • cash • accounts receivable • inventories/supplies • furniture • premises • land 		<i>External sources</i> <ul style="list-style-type: none"> • accounts payable • loans from banks • loans secured by mortgage⁴ • loans from finance companies 	<i>Internal sources</i> <ul style="list-style-type: none"> • capital contribution of the owner
A	=	L	+ OE

It can be seen from the equation that the uses or forms the funds take can never be greater than the amount supplied from the various sources. This is only common sense, because every possible source of funds (both internal and external) is covered, as is every possible use of the funds. (Funds that are not spent remain in cash, which is still an asset of the business.) Thus the situation of $A > L + OE$ (assets being greater than liabilities plus owner's equity) could never exist.

The alternative, $A < L + OE$ (assets being less than liabilities plus owner's equity), could similarly not hold true. If this equation were true, it would mean that the amounts of money borrowed from the various sources ($L + OE$) and owed would be greater than the sums of money the business has to use. Again, common sense would show that this is not possible. Thus we have proved that the relationship is an equality; that is, $A = L + OE$. Note again that the discussion about the accounting equation only has meaning because of the accounting entity concept. This gives us the concept of owner's equity. Owner's equity exists because the owner is regarded as separate from the business, and thus the business regards the owner as a special liability. Hence we are able to derive the accounting equation.

Check for understanding

- 2.12 a State the accounting equation and **describe** the various elements in the equation and the relationship between them.
- b **Create** a paragraph to **explain** the connection between the concept and the equation.
- 2.13 'Total assets must always equal total liabilities plus total owner's equity.' **Create** a paragraph to **explain** this statement.
- 2.14 'Owner's equity is really a special liability.' **Create** a paragraph to **explain** this statement.
-

⁴ If a business has a loan secured by a mortgage over land and buildings, an acceptable way of saying this is 'mortgage on land and buildings'. However, it is important to note that the loan is the liability. The mortgage is the document that sets out details of the security for the loan.

Statement of Financial Position

The accounting equation is an extremely important concept in accounting. Almost all the work that follows in this book flows from this equation. From a practical viewpoint, however, one problem with the equation is that it only shows the relationship between total assets, total liabilities and total owner's equity.

For many reasons, businesses wish to know the individual assets and liabilities. These can be set out in a Statement of Financial Position. Such a statement can also be known as a Balance Sheet.

A Statement of Financial Position is a list of all the assets, liabilities and owner's equity of an organisation at a particular point in time.

The Statement of Financial Position is the detailed expression of the accounting equation. Consider the example of J Graham (page 29). The Statement of Financial Position would be:

J Graham			
Statement of Financial Position as at 30 June 2026			
	\$		\$
Assets		Liabilities	
Cash at Bank	10 000	Loan from Asco Finance Co	20 000
Supplies	1 000		
Furniture	14 000	Owner's Equity	
Motor Vehicle	<u>15 000</u>	Capital	<u>20 000</u>
	<u>\$40 000</u>		<u>\$40 000</u>

This Statement of Financial Position is displayed in the T or account form. Note that with the T form, the assets could just as easily and correctly be displayed on the right-hand side and the liabilities on the left-hand side.

An alternative display, called the narrative form, could have been chosen:

J Graham			
Statement of Financial Position as at 30 June 2026			
	\$		\$
Assets			
Cash at Bank	10 000		
Supplies	1 000		
Furniture	14 000		
Motor Vehicle	<u>15 000</u>		40 000
Less Liabilities			
Loan from Asco Finance Co			<u>20 000</u>
Net assets			<u>\$20 000</u>
Owner's Equity			
Capital			<u>\$20 000</u>

Both display methods are commonly used, so you should become familiar with them. Use them interchangeably in exercises.

Note that the Statement of Financial Position totals give the accounting equation:

T form	A (\$40 000)	=	L (\$20 000) + OE (\$20 000)
Narrative form	OE (\$20 000)	=	A (\$40 000) – L (\$20 000)

This shows that the Statement of Financial Position is merely the detailed expression of the accounting equation.

Check for understanding

2.15 **Analyse** the Statement of Financial Position of K West, trading as West Services, and answer the following questions.

West Services					
Statement of Financial Position as at 30 June 2026					
	\$	\$		\$	\$
Assets			Liabilities		
Cash in Hand		10	Accounts Payable		
Cash at Bank		100	S Fall	300	
Accounts Receivable			T Stevens	<u>500</u>	800
J Johnson	500		Loan from Bank		1 000
J Loxton	<u>200</u>	700	Mortgage on Premises	<u>2 000</u>	3 800
Supplies		800			
Furniture		2 000	Owner's Equity		
Premises		<u>14 000</u>	Capital – K West		<u>13 810</u>
		<u>\$17 610</u>			<u>\$17 610</u>

- a Who is the owner of the business?
- b How much is the owner's investment in the business?
- c Which people owe the business money?
- d What is another name for accounts receivable?
- e To whom does the business owe money?
- f What is another name for accounts payable?
- g Explain the term 'supplies'.
- h Explain the meaning of 'mortgage on premises'.
- i In what form is the Statement of Financial Position?
- j Prepare the Statement of Financial Position in another form.
- k What is the accounting equation corresponding to this new Statement of Financial Position?
- l What is another name for a Statement of Financial Position?

2.16 S Clunes commenced business with the following assets and liabilities:

	\$		\$		\$
Cash at Bank	1 000	Furniture	1 500	Equipment	10 000
Inventories	2 000	Vehicle	6 000	Loan from Bank	4 000

Analyse the items and draw up the Statement of Financial Position to indicate the position of S Clunes' business on 1 July 2026, using:

- a the narrative form of presentation
- b the T form of presentation.

Changes in the Statement of Financial Position as a result of transactions

We have looked at an equation and a Statement of Financial Position at a particular date. Once a business is operating, however, the amounts of assets, liabilities and owner's equity continually change as transactions take place.

Transactions are financial events that affect the elements of the accounting equation.

Thus, each transaction must be analysed for its effect on the assets, liabilities and owner's equity of the business. At least two items will change as a result of every transaction. In fact, with the goods and services tax (GST) being added to most transactions, three or four items in the equation are often affected.

To simplify matters at this stage, assume that the businesses examined are not registered for GST. This allows you to ignore its effects on transactions and concentrate instead on understanding the basics. The effects of GST will be included in Chapter 4, where appropriate.

Consider the following:

2026	
Jan 1	J Gough commenced business as Gough Enterprises by depositing \$100 000 in cash as capital.
2	Bought a vehicle at a total cost of \$10 000, paying cash.
4	Bought furniture with a total cost of \$5 000 from J Jones & Co on credit.
5	Sold vehicle for \$10 000 cash.

Show a new Statement of Financial Position after each transaction. Remember that the transactions are always analysed from the business's viewpoint.

Jan 1 J Gough commenced business as Gough Enterprises by depositing \$100 000 in cash as capital.

This results in an asset (cash at bank) of \$100 000 being equal to owner's equity (capital) of \$100 000.
 $A (\$100\ 000) = L (0) + OE (\$100\ 000)$

Gough Enterprises
Statement of Financial Position as at 1 January 2026

	\$		\$
Assets		Owner's Equity	
Cash at Bank	100 000	Capital – J Gough	100 000
	<u>\$100 000</u>		<u>\$100 000</u>

Jan 2 Bought a vehicle for \$10 000 cash.

This results in a new asset (vehicle) of \$10 000 and a decrease of \$10 000 to the asset (cash at bank).
 $A (\$100\,000 + \$10\,000 - \$10\,000) = L (0) + OE (\$100\,000)$

Gough Enterprises
Statement of Financial Position as at 2 January 2026

	\$		\$
Assets		Owner's Equity	
Cash at Bank	90 000	Capital – J Gough	100 000
Vehicle	10 000		
	<u>\$100 000</u>		<u>\$100 000</u>

Jan 4 Bought furniture for \$5000 from J Jones & Co on credit.

This results in a new asset (furniture) of \$5000 and an increase of \$5000 to the liability (J Jones & Co).
 $A (100\,000 + \$5000) = L (0 + \$5000) + OE (\$100\,000)$

Gough Enterprises
Statement of Financial Position as at 4 January 2026

	\$		\$
Assets		Liabilities	
Cash at Bank	90 000	J Jones & Co	5 000
Vehicle	10 000		
Furniture	5 000	Owner's Equity	
	<u>\$105 000</u>	Capital – J Gough	100 000
			<u>\$105 000</u>

Jan 5 Sold vehicle for \$10 000 cash.

This results in the asset (cash at bank) being increased by \$10 000, and the asset (vehicle) being decreased by \$10 000.

$A (\$105\,000 + \$10\,000 - \$10\,000) = L (\$5000) + OE (\$100\,000)$

Gough Enterprises			
Statement of Financial Position as at 5 January 2026			
\$		\$	
Assets		Liabilities	
Cash at Bank	100 000	J Jones & Co	5 000
Furniture	5 000	Owner's Equity	
		Capital – J Gough	100 000
	<u>105 000</u>		<u>105 000</u>

You can see from the above Statements of Financial Position that, no matter what transaction takes place, the accounting equation is still an equality.

Check for understanding

2.17 Analyse each of the following transactions and draw up a new Statement of Financial Position and accounting equation after each transaction.

2026	
June	1 S Patel commenced business with supplies \$800 and cash \$10 000.
	2 Bought furniture worth \$1000 (from Furnitureland Co), paying a deposit of \$400 and agreeing to pay the balance within a month.
	6 Borrowed \$3000 from the bank towards meeting some future purchases.
	7 Bought land for \$10 000 from Finance Co Ltd.
	10 Paid Furnitureland Co \$200.
	11 Purchased supplies for \$300 cash.

2.18 Analyse the following series of Statements of Financial Position and state the transactions that occurred to change them in each case.

G Wilson			
Statement of Financial Position as at 1 December 2026			
\$		\$	
Assets		Liabilities	
Cash at Bank	3 000	C Whell	1 000
Inventories	500	Owner's Equity	
Vehicle	5 000	Capital	7 500
	<u>8 500</u>		<u>8 500</u>

G Wilson			
Statement of Financial Position as at 2 December 2026			
\$		\$	
Assets		Liabilities	
Cash at Bank	2 000	Owner's Equity	
Inventories	500	Capital	7 500
Vehicle	<u>5 000</u>		<u>7 500</u>
	<u>7 500</u>		<u>7 500</u>

G Wilson			
Statement of Financial Position as at 8 December 2026			
\$		\$	
Assets		Liabilities	
Cash at Bank	2 000	Furniture Traders	2 000
Inventories	500		
Furniture	2 000	Owner's Equity	
Vehicle	<u>5 000</u>	Capital	<u>7 500</u>
	<u>\$9 500</u>		<u>\$9 500</u>

G Wilson			
Statement of Financial Position as at 10 December 2026			
\$		\$	
Assets		Liabilities	
Cash at Bank	4 000	Furniture Traders	2 000
Inventories	500		
Furniture	2 000	Owner's Equity	
Vehicle	<u>5 000</u>	Capital	<u>9 500</u>
	<u>\$11 500</u>		<u>\$11 500</u>

2.19 Analyse the following transactions and draw up a new Statement of Financial Position and equation after each.

2026	
June 1	J McMahon commenced business trading as McMahon's Services with: cash at bank \$10 000; supplies \$1250; furniture \$500; equipment \$2000.
3	Sold the equipment for \$2000 cash.
4	Bought new furniture \$500 for cash from E Gordon.
6	Bought second-hand vehicle (worth \$1000) from A Holt on credit.
7	Owner introduced more cash \$2000.

Fundamental concepts and principles

At this point, we have examined three of the basic concepts of accounting: assets, liabilities and owner's equity. The final two concepts — revenue and expenses — will now be examined.

Revenues

Examples of revenue items are sales, service fees revenue, rent revenue and interest revenue.

Revenue is an inflow of resources to the business. It increases equity and results from:

- the sale of inventories
- services performed
- general operations of the business.⁵

Most businesses exist to make a profit. They do this either by performing services (doctors, hairdressers, plumbers and so on), or by selling goods (supermarkets, butchers, hardware stores, department stores and so on). Of course, many businesses provide a combination of both services and goods; for example, a motor repair store that both repairs vehicles and sells car accessories and repair items.

Those businesses that perform services derive their main form of revenue from the performance of services (**service fees**), whereas other businesses' main source of revenue is the sale of goods (**sales**).

You should note that the sales of goods or inventories are revenue items because such sales occur in the course of the ordinary activities of the business. They should be clearly distinguished from the sale of (other) assets – such as furniture, motor vehicles, plant and equipment – which were originally purchased for use in the business over a long period of time.

Expenses

In the course of operations, a business will incur expense items that are necessary for the continued operation of the business but for which no long-term benefit will be obtained (electricity, rates, accounting fees, advertising, wages and so on).

Businesses that perform services have to purchase necessary materials called consumable supplies. For example, an electrician needs to have a supply of wire and switches to use in the performance of services as they attempt to earn a profit. A plumber will have supplies of washers, pipes and glues. The purchase of supplies is an asset. The use of these supplies on a job when performing a service is an expense.

Firms that specialise in the sale of goods have to determine their cost of goods sold to enable them to see if they have made a profit. For example, supermarkets need to buy a wide range of inventories, have them delivered to the store, package some of them, and pack them on shelves available to sell. They then need to compare the amount they receive for selling the goods with what the goods cost them in order to see if they have earned a profit or made a loss. The expense is called cost of goods sold.

Expense items are necessary in the course of ordinary business activities and are intended to be used within a short period of time. They should be clearly distinguished from the purchase of assets that will be kept for a long period of time, such as furniture, land, buildings and motor vehicles.

5 'Income' (which includes revenue and gains but for our purposes is essentially the same as revenue) 'is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants': Extract from Australian Accounting Standards Board, *Framework for the Preparation and Presentation of Financial Statements*, para 70(a), p10: https://www.aasb.gov.au/admin/file/content105/c9/Framework_07-04_COMPmay19_01-20.pdf. 'Revenue arises in the course of the ordinary activities of an entity' (Extract from Australian Accounting Standards Board, *Framework for the Preparation and Presentation of Financial Statements*, para 74, p10: https://www.aasb.gov.au/admin/file/content105/c9/Framework_07-04_COMPmay19_01-20.pdf).

Expenses are an outflow of resources from a business. They decrease equity and result from:

- services performed
- cost of goods sold
- general operations of the business.⁶

Statement of Profit or Loss

So far we have examined the Statement of Financial Position and its various components: assets, liabilities and owner's equity accounts.

Most businesses wish to know more about their operations. How they are operating or performing on a day-to-day basis (particularly whether they are making a profit or a loss) is extremely important to them. To determine this, we need to find the difference between revenues and expenses for the period. Profit or loss for a period of time, such as a year, is determined in a **Statement of Profit or Loss**. Such a statement can also be known as a Profit and Loss Statement or an Income Statement.

The Statement of Profit or Loss details the various revenues and expenses for a period and calculates the resultant profit or loss.

A simple Statement of Profit or Loss for a business providing services would look like the following:

Grace Services		
Statement of Profit or Loss for year ended 30 June 2026		
	\$	\$
Revenue		
Service Fees Revenue		100 000
Less Expenses		
Advertising	15 000	
Electricity	1 000	
Insurance	2 000	
Office Expenses	3 500	
Postage	500	
Wages	15 000	<u>37 000</u>
Net profit		<u>\$63 000</u>

This statement tells us that the business had total revenue of \$100 000 and total expenses of \$37 000, and made a net profit of \$63 000.

⁶ 'Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants' (Extract from Australian Accounting Standards Board, *Framework for the Preparation and Presentation of Financial Statements*, para 70(b), p10: https://www.aasb.gov.au/admin/file/content105/c9/Framework_07-04_COMPmay19_01-20.pdf). 'Expenses . . . arise in the course of the ordinary activities of the entity' (Extract from Australian Accounting Standards Board, *Framework for the Preparation and Presentation of Financial Statements*, para 78, p11: https://www.aasb.gov.au/admin/file/content105/c9/Framework_07-04_COMPmay19_01-20.pdf).

Comparison of various accounts for a sole trader and a public company

At this point, we have primarily looked at the assets, liabilities, equity, revenues and expenses of a sole trader. We should now consider the position of a public company. As we saw in Chapter 1, one of the primary differences between a sole trader and a public company is that a company is a separate legal entity. Hence, it can raise capital, and enter into debt contracts in its own name. It is also taxed as an individual entity, and the shareholders receive distributions in the form of dividends. Compare this to the case of a sole trader. The business is not legally regarded as separate from the owner (even though from an accounting perspective the business is a separate accounting entity), hence the owner is legally responsible for any debts of the business. The business is not taxed in its own right, but rather the business distributes profits to the owner and the owner pays tax on those profits.

The differences between accounting for a sole trader and a company are summarised in Table 2.1.

Table 2.1 Accounting differences between a sole trader and a company

Feature	Sole trader	Company
Legal entity	Business is not a separate legal entity; the owners are responsible for all debts	Company is a separate legal entity
Liabilities		Can issue debt in their own name (debentures or unsecured loans)
Expenses		May have additional expenses; for example, audit fees, directors' fees, interest on debentures. Legal and administrative costs of forming the company are also treated as an expense
Components of equity	Capital account	Share capital/Contributed equity, Reserves, Retained earnings accounts
Distributions to owners	Drawings	Dividends
Payment of tax	Individuals pay tax in their own name. Does not appear as an expense in the business's records. Individuals pay tax on the total profit of the business	Company pays tax. Appears as an income tax expense in the company's records

Check for understanding

2.20 Create a paragraph to **describe** the difference between the way a sole trader is taxed and the way a company is taxed.

Statement of Cash Flows

The **Statement of Cash Flows** is of equal importance to the Statement of Profit or Loss and the Statement of Financial Position. Having adequate cash is crucial for a business to achieve its objectives.

A Statement of Cash Flows shows the cash inflows of a business entity during a period, and the cash outflows from the business during that period.

A Statement of Cash Flows is a general purpose financial report that will provide information useful to users in making and evaluating decisions about the allocation of scarce resources. It can be prepared from the Cash at Bank account.

The main purpose of a Statement of Cash Flows is to highlight the operating, investing and financing activities of the entity during a period.

The Statement of Profit or Loss concentrates on the revenues and expenses of the business and is used to determine the profit. The Statement of Financial Position shows the financial position of the business in terms of all asset, liability and owner's equity items. These reports help the business to determine how well it has achieved its objectives in terms of profitability, and to some extent in terms of financial stability and solvency. However, these statements do not clearly indicate the ability of the business to:

- generate positive cash flows (so inflows are greater than outflows)
- pay **debts** as they fall due
- fund future **expansion** projects
- obtain funds from **owners**, lenders and so on, as required
- pay **drawings** (sole trader, partnership) and **dividends** (company).

You will already realise that there is a great difference between profit and cash – between profitability and remaining solvent and financially stable. Profit is usually determined using the accrual basis of accounting. This can often mean that although profit has been recognised, no cash has been received. The business may not be able to meet its financial commitments. Indeed, there have been many businesses that have failed due to their inability to get their timing of cash inflows and outflows correct.

A Statement of Cash Flows should:

- clarify information shown in the financial statements by **disclosing cash flows** in and out of the entity, which may not be readily revealed in the other statements
- assist management in understanding **changes in financial position**
- assist external users in making decisions concerning **capital contributions or loans**
- assist in assessing the ability of an entity to **generate cash flows in the future**
- assist the development and evaluation of **investment expenditure programs**, which could involve changes in the scope and/or nature of a business's activities
- assist in **obtaining external finance** where necessary.

Such information is vital to the operation, survival and growth of an entity.

Better management decisions should result because these linkages and clarifications of fund flows can more easily be seen by management.

Management must carefully consider all available sources and uses of funds. **External** sources of funds, such as banks and finance companies, charge different interest rates and require repayment over varying lengths of time. **Internal** sources, such as owners' contributions and retained earnings, have fewer such restrictions but may be more limited in amount. The business must use its funds to obtain the greatest possible return for the least risk. Large projects may cause the business to be short of funds for many years to come. Indeed, if a large project were to fail it could well mean the business's financial ruin.

The nature of cash and cash flows

Cash means cash on hand and demand deposits (such as cash at bank). Cash equivalents are short-term, highly liquid investments that are readily converted to cash (such as deposits on call).

Cash does not include such items as accounts receivable, equity securities (such as shares), accounts payable, or any borrowings subject to a term facility. These are not readily converted to cash.

Cash flows are inflows and outflows of cash and cash equivalents.

Having established that cash flows can be either inflows or outflows, there are three main types of cash flows that come from the main activities of every business:

- First, **operating activities** are the principal revenue producing activities of the entity. Operating activities are the main daily activities through which a business remains viable. The main inflows relating to operating activities can occur from the receipts from customers for services or sales of goods. Likewise, outflows relating to operating activities occur from the payment to suppliers for the purchase of goods, but also for the payment of other operating expenses such as advertising and wages.
- Second, **investing activities** are the principal ways in which businesses invest in their operating capacity, such as acquiring long-term assets. If the business purchased a long-term asset, then that would represent an outflow of funds. Likewise, if a business sold some long-term assets or investments, that would represent a cash inflow of funds.
- Third, **financing activities** are those activities that result in changes in the manner in which the business is financed. As discussed with the accounting equation, the business is financed either through external sources (debt) or internal sources (owners). Cash inflows and outflows can be associated with financial activities. For example, if a new loan was raised, that would represent a cash inflow. If drawings or dividends were paid to owners, that would represent a cash outflow.

Cash can flow into and out of a business for many reasons, as shown in Figure 2.1. All these examples would be regarded as cash flows and would be reported in the Statement of Cash Flows. Most would be reflected in the business's Cash at Bank account.

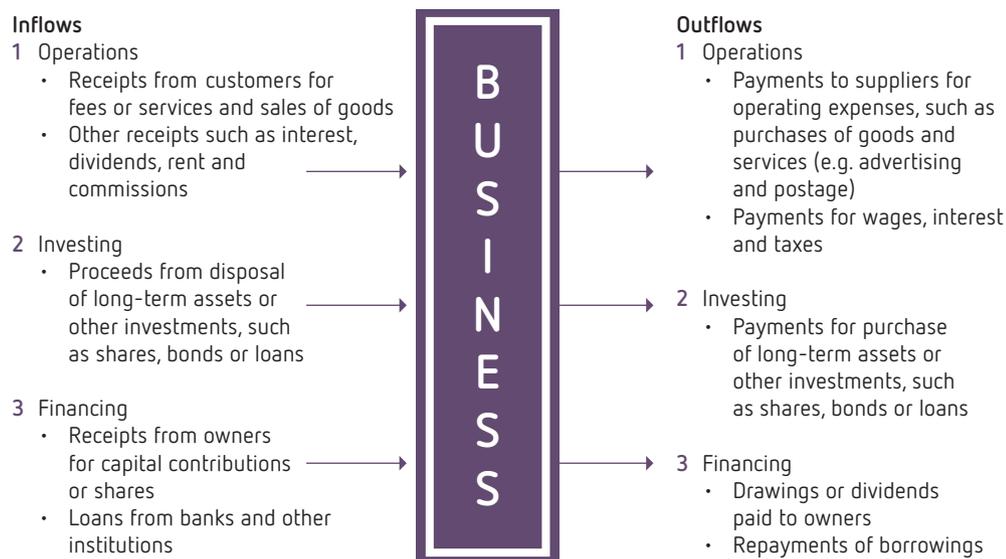


Figure 2.1 Cash flows in and out of a business

For transactions or items to be regarded as a cash flow and be reported in the Statement of Cash Flows, the following conditions must be satisfied:

- The transaction must involve a **cash flow**. Therefore, transactions such as selling services on credit to accounts receivable, purchasing on credit from accounts payable, purchasing or selling non-current assets on credit, or exchanging one non-current asset for another, would not be reported in the statement. (However, the cash flows that result when credit transactions are paid for or received would be included.)
- The transaction must involve an **external party**. Therefore, transactions such as transfers of cash from one account to another, depreciation and amortisation are simply entries in our own books and would not be reported in the statement.

Such transactions are still important in the overall funding decisions of the organisation, but they do not result directly in cash flows. They are often reported as notes below the statement to give more complete information to users of the Statement of Cash Flows.

The following is an example of a Statement of Cash Flows. Many businesses and accountants do not separate inflows and outflows in each section. They show outflows in brackets.

XYZ Industries			
Statement of Cash Flows for the period ended 30 June 2026			
	\$	\$	\$
Cash flows from operating activities			
<i>Inflows</i>			
Receipts from customers	90 000		
Dividends received	1 000		
Interest received	500		
Other operating revenue	<u>200</u>	91 700	
<i>Outflows</i>			
Payments to suppliers for purchases	30 000		
Payments to employees	40 000		
Interest paid	1 000		
Payments for other operating expenses	<u>10 000</u>	<u>81 000</u>	
Net cash from operating activities⁷			10 700
Cash flows from investing activities			
<i>Inflows</i>			
Proceeds from sale of long-term assets and other investments	<u>0</u>	0	
<i>Outflows</i>			
Payments for long-term assets and other investments	<u>10 000</u>	<u>10 000</u>	
Net cash used in investing activities⁷			(10 000)
Cash flows from financing activities			
<i>Inflows</i>			
Proceeds from capital contributions	20 000		
Proceeds from borrowings	<u>0</u>	20 000	
<i>Outflows</i>			
Repayment of borrowings	0		
Payment of drawings	<u>2 000</u>	<u>2 000</u>	
Net cash used in financing activities⁷			<u>18 000</u>
Net increase (decrease) in cash held			18 700
Cash at beginning of reporting period			<u>10 000</u>
Cash at end of reporting period			<u><u>28 700</u></u>

⁷ Cash can be either 'from' or 'used in' each of the three types of activities, depending on whether inflows or outflows are higher.

The Statement of Cash Flows for XYZ Industries reveals some very interesting facts about its operations for the financial year 2025–2026, which would not be available from examining the Statement of Financial Position or the Statement of Profit or Loss.

- The cash position increased over the year by \$18 700.
- The operating activities for the year contributed \$10 700 to the increase in the cash position.
- The owners contributed \$18 000 to the business during the year.
- The business invested \$10 000 of its cash in the purchase of long-term assets (investing activities).

This information will assist the owners and managers in analysing the operations of the business for the year and determine operating strategy moving forward.

Check for understanding

- 2.21 **Create** a paragraph to **explain** the purposes of preparing a Statement of Cash Flows.
- 2.22 **Describe** the terms ‘cash’, ‘cash equivalents’ and ‘cash flows’.
- 2.23 List the main inflows and outflows of cash for a service concern. Briefly **describe** how you believe these might change for a trading organisation, a government organisation and a financial institution.
- 2.24 **Explain** how the Statement of Cash Flows provides a link between the Statement of Profit or Loss and the Statement of Financial Position.
- 2.25 **Identify** whether the following transactions are cash flows or non-cash flows:
- a Bought furniture on credit from Furniture Traders Ltd for \$5000.
 - b The owner, A Allen, paid in \$10 000 cash as additional capital.
 - c Sold a motor vehicle for cash at its book value of \$8000.
 - d Exchanged \$60 000 shares in ABC Ltd, which were purchased as an investment, for a block of land valued at \$60 000.
 - e Paid drawings of \$500 cash to the owner, A Allen.
 - f Drawings of \$500 goods to the owner, A Allen.
 - g Received cash \$1000 from A Customer, an accounts receivable.
 - h Received allowance of \$50 from A Supplier, an accounts payable.
 - i Provided for depreciation of \$5000 on motor vehicle.
- 2.26 In this book, the names used for the financial statements are the Statement of Profit or Loss, the Statement of Financial Position and the Statement of Cash Flows. These are the names stipulated in the Australian Accounting Standard AASB 101.
- Refer to the 2023 annual reports for Woolworths, Qantas, Flight Centre and JB Hi-Fi by following the weblinks.
- a **Analyse** the reports of each of these public companies and **identify** the names given to these financial reports.
 - b From your analysis, what conclusions can you draw?



Weblinks
Woolworths
Limited annual
report

Qantas Airways
annual report

Flight Centre
annual report

JB Hi-Fi annual
report

CHAPTER REVISION

2.27 Multiple choice

Complete the following multiple-choice questions by choosing the best answer.

- Which of the following items is not an asset?
 - A loan from the bank
 - Inventories
 - Furniture
 - Investments
- Which of the following items is not a liability?
 - A loan from the bank
 - Bank overdraft
 - Accounts payable
 - Accounts receivable
- Which of the following equations is incorrect?
 - $L = A - OE$
 - $OE = A - L$
 - $A = L + OE$
 - $L = A + OE$
- You are given the following items and asked to find the value of the missing item Accounts Receivable.
Equipment \$3 000; Cash at Bank \$1 000; Capital \$5 000; Accounts payable \$500; Inventories \$750. What is the value of Accounts receivable?
 - \$7750
 - \$10 250
 - \$750
 - none of the above
- At the bottom of the page, you are provided with a Statement of Financial Position for Witij Witij Enterprises.
The only transaction that occurred on 1 July 2026 was that the owner introduced \$3000 worth of supplies and \$10 000 cash into the business. Which of the following statements is correct?
 - On 1 July 2026 the value of capital is \$61 000.
 - On 1 July 2026 the value of the truck is \$20 000.
 - On 1 July 2026 the value of cash at bank is \$63 000.
 - On 1 July 2026 the value of the loan from Finance Co is \$33 000.
- Which of the following statements is incorrect?
 - A sole trader cannot raise money from the public.
 - The payment of tax by a sole trader appears as an expense in the Statement of Profit or Loss.
 - A company is regarded as a separate accounting entity and a separate legal entity.
 - A sole trader is not regarded as a separate legal entity but is regarded as a separate accounting entity.

Witij Witij Enterprises Statement of Financial Position as at 30 June 2026

Assets		
Cash at Bank	50 000	
Supplies	1 000	
Truck	<u>20 000</u>	71 000
Less Liabilities		
Loan from Finance Co		<u>20 000</u>
Net assets		<u>51 000</u>
Owner's equity		
Capital		<u>51 000</u>

- 7 Consider the transaction: Bought furniture on credit from Furniture Solutions Pty Ltd for \$50 000. Which of the following statements is correct?
- A This transaction affects the Statement of Cash Flows and the Statement of Profit or Loss.
- B This transaction affects the Statement of Profit or Loss and the Statement of Financial Position.
- C This transaction affects the Statement of Cash Flows and the Statement of Financial Position.
- D None of the above.
- 8 Consider the transaction: Received cash of \$5000 from A Brusenov, a customer. Which of the following statements is correct?
- A This transaction affects the Statement of Cash Flows and the Statement of Profit or Loss.
- B This transaction affects the Statement of Profit or Loss and the Statement of Financial Position.
- C This transaction affects the Statement of Cash Flows and the Statement of Financial Position.
- D None of the above.
- 9 Which of the following statements is incorrect?
- A If an owner contributes additional cash of \$100 000 into the business, this will appear as an operating activity in the Statement of Cash Flows.
- B If a company pays interest of \$100 000, this will appear in the Statement of Profit or Loss, whereas if the business is a sole trader, it will not appear in the Statement of Profit or Loss.
- C If a business made a profit of \$100 000, then the Cash at Bank account would increase.
- D All of the above.
- 10 Which statement is incorrect?
- A All liabilities arise from a cash inflow.
- B All revenues arise from a cash inflow.
- C All owner's equity items arise from a cash inflow.
- D All of the above.

2.28 Case study

Stimuli 1–3 relate to Kyle Juney, an electrician.

STIMULUS 1

Kyle Juney Electrical			
Statement of Financial Position as at 30 June 2026			
	\$		\$
Assets		Liabilities	
Cash at Bank	2 000	Loan from P Nemin	20 000
Supplies	3 000		
Accounts receivable	30 000		
Tools	18 000	Owner's Equity	
Motor Vehicle	<u>51 000</u>	Capital	<u>84 000</u>
	<u>\$104 000</u>		<u>\$104 000</u>

STIMULUS 2

The business has been trading for over 5 years and commenced with capital of \$70 000 and no debt.

STIMULUS 3

Net profit for the financial year ended 30 June 2026 is \$2700

Using the information provided in Stimuli 1–3:

- a **Create** a paragraph outlining how you think the business has performed.
- b Assume you are the credit manager of a large supplier of electrical goods called Nurvana Electrical Ltd. Kyle has approached you to open a credit account so he can buy goods during the month and then pay by the middle of the next month. **Create** a paragraph explaining what decision you would make with regard to the granting of credit and why.

2.29 Case study

Analyse the information provided in Stimulus 1 and **identify** the transaction(s) that resulted in the position each day. Assume the business commenced on 1 June.

STIMULUS 1

Statement of Financial Position				
As at	1 June	2 June	3 June	4 June
Assets	\$	\$	\$	\$
Cash at Bank	10 000	5 000	2 000	0
Vehicle	70 000	70 000	90 000	90 000
Furniture	<u>0</u>	<u>18 000</u>	<u>18 000</u>	<u>18 000</u>
TOTAL ASSETS	<u>80 000</u>	<u>93 000</u>	<u>110 000</u>	<u>108 000</u>
Liabilities				
Bank overdraft	0	0	0	21 000
Suppliers Ltd	<u>10 000</u>	<u>23 000</u>	<u>23 000</u>	<u>0</u>
TOTAL LIABILITIES	<u>10 000</u>	<u>23 000</u>	<u>23 000</u>	<u>21 000</u>
NET ASSETS	<u>70 000</u>	<u>70 000</u>	<u>87 000</u>	<u>87 000</u>
Owner's Equity				
Capital	70 000	70 000	70 000	87 000
Add new capital	0	0	20 000	0
Less drawings	<u>(0)</u>	<u>(0)</u>	<u>(3 000)</u>	<u>0</u>
	<u>70 000</u>	<u>70 000</u>	<u>87 000</u>	<u>87 000</u>

3

FUNDAMENTALS OF PROCESSING TRANSACTIONS

LEARNING OBJECTIVES

At the end of this chapter you should be able to:

- explain the interrelationships between assets, liabilities, owner's equity, revenue and expenses
- analyse the effect of transactions, and prepare debit and credit entries for these transactions
- analyse and interpret the similarities and differences between the various accounts that comprise assets, liabilities, owner's/shareholder's equity, revenue and expenses for a sole trader and a public company.

Fundamentals of processing transactions

Ledger accounts

- Need for accounts
- Format of accounts
 - T account format
 - Columnar format
- Account rules
- Analysing transactions
 - Revenues
 - Expenses

Summary of rules for recording transactions

Preparation of ledger accounts

- Chart of accounts
- Preparation of T ledger accounts
 - T account balancing
- Preparation of columnar ledger accounts

Trial balance

- Function of the trial balance
- Preparation of the trial balance
- Errors not disclosed by the trial balance
- Locating trial balance errors

Chapter revision

Weblinks:

- Double-entry bookkeeping (p.55)
- Qantas Airways annual reports (p.74)



 Nelson MindTap

To access resources above, visit
cengage.com.au/nelsonmindtap

Ledger accounts

Need for accounts

Many transactions occur in all businesses every day and it would be almost impossible to draw up a new Statement of Financial Position after every transaction. What is needed is some device where changes to a particular item (e.g. cash at bank) can be recorded or an account of it kept. Such a device is called an account (and abbreviated as 'a/c').

An account is a record in a ledger where all changes to a particular item are shown.

Every item in the Statement of Financial Position has an account. Therefore, the record where all changes to the item 'furniture' are shown is called the Furniture account. All these accounts are kept together in a ledger.

A ledger is a collection of all the accounts.

Check for understanding

3.1 Use the Statements of Financial Position you have prepared as a guide to **identify** all the ledger accounts you can think of.

Format of accounts

Ledger accounts keep a record of what happens to a particular item. There are two common methods of presenting accounts:

- T account format
- columnar format.

T account format

T accounts are simply records of particular items from a ledger drawn up in the form of a T:

Cash at Bank

This format is normally used in conceptual accounting. It makes understanding and learning easier. Information is recorded on both sides of this account, and so a fuller T account appears as:

Dr		Cash at Bank				Cr	
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount
			\$				\$

The left-hand side of a ledger account is called the debit (Dr) side and the right-hand side is called the credit (Cr) side.

Columnar format

The following is a typical columnar format account:

Cash at Bank					
Date	Particulars	Ref	Debit	Credit	Balance
			\$	\$	\$

The columnar format gets its name from the fact that there are three money columns to every account. This form of account is particularly suitable for computerised accounting.

You should note that, although the formats appear different, the information contained in both formats is similar and they produce the same results.

Account rules

A basic assumption of accounting is:

Asset accounts have a debit nature.

Accounting is quite logical and mathematical in approach, and any additions are recorded on the same side as the nature of the account. Therefore, increases to asset accounts are recorded on the debit side. Any decreases to asset accounts are recorded on the opposite side – the credit side.

Consider the following asset account:

Dr				Cash at Bank				Cr	
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount		
			\$				\$		
			1 000						

The recording of this \$1000 means that the business has \$1000 in the bank. If the business now receives another \$500, by applying the logic above, this will be entered on the debit side. If the business then pays out \$200, this will be entered on the credit side.

The Cash at Bank account would then appear as follows:

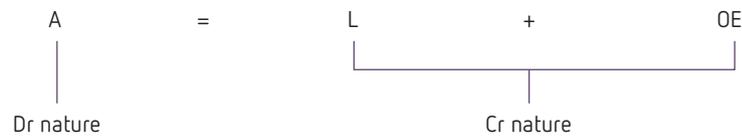
Dr				Cash at Bank				Cr	
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount		
			\$				\$		
			1 000				200		
			500						

From this, the following rules may be deduced:

Increases to accounts are recorded on the same side as the nature of the account.
Decreases to accounts are recorded on the opposite side to the nature of the account.

These are important rules of accounting, and their applicability can be seen again in relation to liability and owner's equity accounts.

Consider the situation with liability accounts. We have already explained that a fundamental assumption of accounting is that assets have a debit nature. Because of the accounting equation, liability accounts are opposite to assets. Thus, having assumed that assets have a debit nature, liabilities and owner's equity have a credit nature because they are on the opposite side of the accounting equation.



Liability accounts have a credit nature.

Examine the following ledger account for S Poole, who is an account payable (a liability).

Dr		S Poole						Cr
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount	
			\$				\$	
							1 000	

From the ledger account and the fact that \$1000 is entered on the credit side, we know that the business owes S Poole \$1000.

Now consider the ledger account after two more transactions have taken place:

Dr		S Poole						Cr
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount	
			\$				\$	
			400				1 000	
							500	

What can we deduce from this? We know two things so far:

- Liability accounts have a credit nature.
- Increases to accounts are recorded on the same side as the nature of the account, and decreases to accounts are recorded on the opposite side to the nature of the account.

We said that the business owed S Poole \$1000. The business owes S Poole a further \$500 because of the entry on the credit side. However, the business has also paid S Poole \$400, and this has been entered on the debit side. Thus the amount owed to S Poole is \$1100.

Now consider the situation with owner's equity accounts.

Owner's equity accounts have a credit nature.

Increases to owner's equity accounts are therefore recorded on the credit side of the account. Decreases to owner's equity accounts are recorded on the debit side of the account.

Consider the following Capital account of an owner.

Dr				Capital				Cr
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount	
			\$				\$	
							50 000	

From the ledger account, and the fact that \$50 000 is entered on the credit side, we know that the business owes the owner \$50 000.

If the owner introduced a further \$10 000 as capital, this would be entered on the credit side. The ledger account would appear as:

Dr				Capital				Cr
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount	
			\$				\$	
							50 000	
							10 000	

Real-world application



The meaning of words

The words 'debit', 'credit', 'debtor' and 'creditor' have their root origins in Latin. 'Debit' comes from the Latin *debere*, meaning 'to owe', and thus relates to money owing as a debt. 'Credit' comes from *credere*, meaning 'to trust', and thus relates to goods given on trust or lent with confidence that the debt will be repaid. These origins explain why debit is abbreviated to Dr and credit to Cr, even though there is now no 'r' in the modern word 'debit'.

Check for understanding

- 3.2 In accounting, assets have a debit nature and liabilities have a credit nature. **Explain** why this is the case.
- 3.3 **Analyse** the furniture account provided and answer the following questions:
- What is the name of the account?
 - What type of account is this – asset, liability or owner's equity?
 - What sort of nature does this account have?

- d Why is \$500 entered on the left-hand side?
- e What is this left-hand side called?
- f Why is \$200 entered on the right-hand side?
- g What is this right-hand side called?
- h On which side of the account would increases be entered?
- i On which side of the account would decreases be entered?
- j How much furniture does the business own at the end of this period?

Dr		Furniture				Cr	
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount
			\$				\$
			1 000				200
			500				

- 3.4 **Analyse** the following ledger accounts and draw up a Statement of Financial Position for Andrews Accounting as at 30 June 2026:

Capital – J Andrews		L Lanazzi (Accounts Payable)	
	\$100 000		\$5 000
P Potter (Accounts Receivable)		Cash at Bank	
\$20 000		\$14 200	
Motor Vehicles		Supplies	
\$40 000		\$300	
Furniture		Shares in ABC Ltd	
\$3 500		\$27 000	

Analysing transactions

We have already seen that every transaction affects two or more items in the Statement of Financial Position. Therefore, each transaction must affect two or more accounts in the ledger. At least one of these accounts will be debited and one will be credited. To analyse transactions into their debit and credit elements, you should determine:

- 1 what ledger accounts are involved; that is, what ledger accounts have been affected by the transactions
- 2 what type of account each of these is; that is, asset, liability or owner's equity
- 3 the nature of the account
- 4 whether the account is increasing or decreasing
- 5 which side of the ledger account is affected
- 6 the amount.

For convenience only, these steps have been incorporated into a table format. This is illustrated in Table 3.1 using some typical transactions for W Green, who starts an advisory service called Green Advice.

Table 3.1 Green Advice

Date	Transaction	Accounts involved	Types of account	Nature of account	Inc/Dec	Dr/Cr	Amount
2026							\$
Jan 1	Owner introduced \$20 000 cash into business	Cash at Bank Capital – W Green	A OE	Dr Cr	Inc Inc	Dr Cr	20 000 20 000
3	Bought vehicle for \$15 000 cash	Motor Vehicle Cash at Bank	A A	Dr Dr	Inc Dec	Dr Cr	15 000 15 000
5	Bought furniture from ABC Co for \$4000*	Furniture ABC Co	A L	Dr Cr	Inc Inc	Dr Cr	4 000 4 000
7	Paid ABC Co \$2000 cash	ABC Co Cash at Bank	L A	Cr Dr	Dec Dec	Dr Cr	2 000 2 000

*Transactions dealing with accounts receivable or accounts payable that do not mention cash are assumed to be on a credit basis; that is, time is given to pay.

Note that for every transaction the total debit amounts equal the total credit amounts. This is called **double entry**. Double entry does not mean that only two accounts are affected.

Double entry means that for every transaction entered in the accounts, total debits equal total credits.

Tables are used only to determine what accounts are involved in a transaction and whether these accounts are debited or credited as a result of transactions. Once you are skilled in analysing transactions, you will not need to draw up a table.

Real-world application



The development and power of double-entry bookkeeping

Luca Pacioli – Father of Accounting

Our world is governed by the numbers generated by the accounts of nations and corporations. We depend on these numbers to direct our governments, organisations, economies, societies. But where did they come from – and how did they become so powerful?

The answer to these questions begins in the Dark Ages, with the emergence in northern Italy of a new form of accounting called double-entry bookkeeping. The story of double entry reaches from the Crusades through the Renaissance to the factories of industrial Britain and the policymakers of the Great Depression and the Second World War. At its heart stands a Renaissance monk, mathematician and magician, and his celebrated treatise for merchants. With double entry came the wealth and cultural efflorescence that was the Renaissance, a new scientific worldview and a new economic system: capitalism.

Over the past one hundred years accounting has flourished to an astonishing degree, despite the many scandals it has left in its wake. The figures double entry generates have become a sophisticated system of numbers which in the twenty-first century rules the global economy, manipulated by governments, financial institutions and the quant nerds of Wall Street.

And the story of double entry is still unfolding – because today it might be our last hope for life on earth.

Source: J. Gleeson-White, *Double entry: How the merchants of Venice shaped the modern world – and how their invention could make or break the planet*, Allen & Unwin, Sydney, 2011.

These are bold claims by Jane Gleeson-White. Follow the weblink to watch the video and gain a deeper understanding of the development of double-entry bookkeeping.



Weblink
Double-entry
bookkeeping

Check for understanding

3.5 Prepare a table to **analyse** the following transactions for Xnguyen Enterprises.

Jan	10	Obtained a \$15 000 loan from the bank.
	17	Bought furniture from ABC Co for \$400.
	19	Purchased a vehicle for \$10 000 cash.
	29	Sold some furniture (which cost \$200) for \$200 cash.
	30	Bought government bonds for \$1000 cash.

3.6 Prepare a table to **analyse** the following business transactions for Masso & Co.

Mar	1	Owner introduced vehicle \$1000 and cash \$500 as capital.
	2	Bought furniture for \$500 from V Jones.
	4	Sold vehicle to S Smith for \$1000.
	7	Paid V Jones \$500 cash.
	9	Received \$1000 from S Smith.

3.7 **Analyse** the following transactions into their debit and credit components for Nguyen Services.

Dec	10	Owner commenced business with \$10 000 cash, supplies worth \$1000 and furniture \$500.
	12	Bought equipment for \$1000 from Suppliers Ltd.
	14	Bought more furniture for \$500 cash.
	17	Paid Suppliers Ltd \$200.

3.8 **Analyse** the following transactions into their debit and credit components for Widjeri Enterprises.

May	2	Owner commenced business by introducing \$600 cash and a vehicle worth \$4000.
	3	The business obtained a \$1000 loan from the bank.
	4	Bought land from ALP Finance Co for \$100 000.
	6	Paid ALP Finance Co \$1000.

Table 3.2 Analysis of accounts (1)

Date	Transaction	Accounts involved	Types of account	Nature of account	Inc/Dec	Dr/Cr	Amount
							\$
Feb 1	Received interest on bonds \$2000	Cash at Bank Interest Revenue	A R	Dr Cr	Inc Inc	Dr Cr	2 000 2 000
3	Performed services for A Smithson \$7000	A Smithson Service Fees Revenue	A R	Dr Cr	Inc Inc	Dr Cr	7 000 7 000
8	Received rent \$5000	Cash at Bank Rent Revenue	A R	Dr Cr	Inc Inc	Dr Cr	5 000 5 000
11	Received \$4000 for services performed	Cash at Bank Service Fees Revenue	A R	Dr Cr	Inc Inc	Dr Cr	4 000 4 000

Consider service fees revenue from Table 3.2. Each time service fees are earned during the accounting period, this would be recorded on the credit side of the Service Fees Revenue account.

Dr				Service Fees Revenue				Cr
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount	
			\$				\$	
							7 000	
							4 000	

Thus, by the end of this period, \$11 000 has been earned as revenue, all recorded on the credit side of the account. Generally, revenue accounts increase and are therefore usually credited.

Check for understanding

3.10 Identify the type of account for each of the following items:

- a Service fees
- b Supplies
- c Inventories
- d Accounts payable
- e Accounts receivable
- f Capital
- g Cash at bank
- h Delivery vehicles

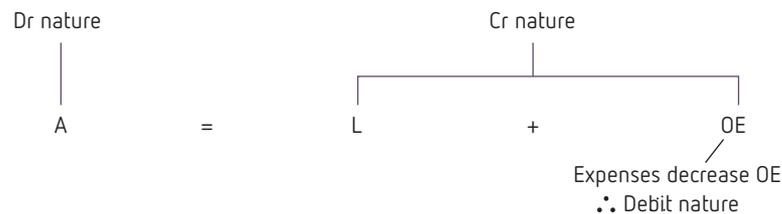
- 3.11 Analyse** the following transactions dealing with revenue items for Le Beaute Hairdressing Salon. **Identify** the account that would be credited as revenue in each case, and the amount that would be recorded on the credit side of the account. What would be the total recorded for the month for services performed?

June	1	Performed services for \$1000 cash.
	15	Performed \$1200 worth of services, \$1000 for cash, and the balance on account for F Kingston.
	25	Received rent from subtenant \$500 cash.
	30	Received interest on bonds \$1000.

Expenses

As discussed on page 38, expenses are incurred that are necessary for the continued operation of the business but for which no long-term benefit will be obtained (electricity, rates, accounting fees, advertising, wages and so on).

The nature of expense accounts comes from the nature of owner's equity accounts. Expense items reduce the profit the business makes. Because expense items have the ultimate effect of decreasing owner's equity, they have a debit nature.



Expense accounts have a debit nature.

Following on from one of the general principles introduced earlier, you know that increases to accounts are recorded on the same side as the nature of the account, and decreases are recorded on the opposite side to the nature of the account. Applying this to expense accounts, increases are recorded on the debit side and decreases are recorded on the credit side. Examples of the analysis of expense accounts are contained in Table 3.3.

Table 3.3 Analysis of accounts (2)

Date	Transaction	Accounts involved	Types of account	Nature of account	Inc/Dec	Dr/Cr	Amount
							\$
Apr 1	Paid electricity bill \$380 to Anagon Electric	Electricity Cash at Bank	E A	Dr Dr	Inc Dec	Dr Cr	380 380
2	Purchased supplies for \$1300 cash	Supplies Cash at Bank	A A	Dr Dr	Inc Dec	Dr Cr	1300 1300
12	Paid wages \$1000	Wages Cash at Bank	E A	Dr Dr	Inc Dec	Dr Cr	1000 1000
15	Purchased supplies for \$800 from D Murray	Supplies D Murray	A L	Dr Cr	Inc Inc	Dr Cr	800 800
18	Paid rates \$1700	Rates Cash at Bank	E A	Dr Dr	Inc Dec	Dr Cr	1700 1700
30	Supplies used \$1300	Supplies Expense Supplies	E A	Dr Dr	Inc Dec	Dr Cr	1300 1300

Note that the entry on 30 April for supplies used is often referred to as a balance day adjustment and will be discussed further in Chapter 6.

In general, expense accounts increase. Therefore, most of the entries in them will appear on the debit side. A Wages account, recording weekly wages for a month, might have the following transactions.

Dr		Wages				Cr	
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount
			\$				\$
			400				
			500				
			500				
			450				

Communication



Explanation

Purpose

The purpose of an explanation is to relate the how and why of certain events, phenomena and issues, as opposed to a description of them.

An explanation can be short or extended, and it may be spoken or written.

How information is communicated

An explanation usually contains an introduction, a body showing reasoning or argument, and a conclusion.

Example

If you were asked to explain why revenue accounts have a credit nature, you could say:

The nature of revenue accounts comes from the nature of owner's equity accounts. Owner's equity accounts have a credit nature. As revenue items have the ultimate effect of increasing owner's equity, and increases go on the same side as the nature of the account, revenues also have a credit nature.

Try writing your own explanations for why owner's equity accounts have credit balances, and why expenses have debit balances.

Summary of rules for recording transactions

Rules of accounting

- Asset accounts are of a debit nature.
- Liability accounts are of a credit nature.
- Owner's equity accounts are of a credit nature.
- Revenue accounts are of a credit nature.
- Expense accounts are of a debit nature.
- Increases are recorded on the same side as the nature of the account.
- Decreases are recorded on the opposite side to the nature of the account.

A	=	L	+	OE
Dr Assets Cr		Dr Liabilities Cr		Dr Owner's Equity Cr
Increase Decrease		Decrease Increase		Decrease Increase
		Dr Expenses Cr		Dr Revenue Cr
		Increase Decrease		Decrease Increase

The main rules for recording accounting transactions have now been covered. These rules will be applied in the next section.

Check for understanding

- 3.12 In your own words, **explain** ‘revenues’ and ‘expenses’. Remember to refer back to the points on the attributes of a good definition in Chapter 1.
- 3.13 As indicated earlier, you should be becoming very familiar with analysing transactions. The tables were used so you could see the whole process of how debit and credit work. In these next two exercises, determine the accounts and types of account to be debited and credited and the amounts involved without preparing a full table. You have to go through exactly the same process, but only write down the accounts and types of accounts to be debited and credited and the amounts involved.

Analyse the following transactions for Thompson Brothers, who are electricians.

June	1	Purchased supplies for \$1500 cash.
	4	Paid wages \$1000.
	9	Paid rates \$2500.
	15	Purchased supplies for \$2000 on account from Electrics Supply Co.
	21	Paid electricity account for \$400.
	28	Paid telephone account to Telstra for \$800.
	30	Supplies used on the jobs \$300.

- 3.14 **Analyse** the following transactions for the service side of Smith’s Garage. **Identify** the accounts and types of accounts to be debited and credited and the amounts involved.

April	3	Paid wages \$1500.
	4	Purchased lubricants used in services from Shell Oil Ltd on account \$2000.
	7	Performed services on cars for cash \$1900.
	10	Performed services on cars for \$2400 with \$300 still owing by Sam Striven.
	20	Paid Shell Oil Ltd \$2000.
	23	Paid wages \$1500.
	27	Paid electricity \$500.
	30	Lubricants used in car services \$100.

- 3.15 **Analyse** the following ledger of G Trivani at 30 June 2026 and **prepare** a Statement of Profit or Loss.

Service Fees Revenue		Advertising	
	\$100 000	\$4 000	
Rent Expense		Sundry Expenses	
\$3 000		\$3 500	
Supplies Expense		Office Expenses	
\$20 000		\$5 000	
Electricity		Telephone	
\$1 500		\$900	

3.16 Classify the following list as revenues, expenses, assets, liabilities or owner’s equity. **Identify** the basic nature of each account.

- | | |
|------------------------------|--------------------------------|
| a Cash at bank | k Delivery expenses |
| b Inventories | l Trade debtors |
| c Sales | m Trade creditors |
| d Accounts payable | n Loan from bank |
| e Shares | o Supplies |
| f Advertising | p Interest expense |
| g Capital | q Rent revenue |
| h Wages and salaries | r Service fees provided |
| i Accounts receivable | s Furniture |
| j Delivery vehicles | t Supplies used |

3.17 Examine each of the following and **explain** the effect on owner’s equity.

- a** Owner commenced a sole trader business with \$100 000 cash.
- b** Owner withdrew \$5000 during the year.
- c** Profit for the year was \$20 000.

3.18 Identify the transactions that give rise to the following double-entry analysis.

Example: Cash at Bank		Dr	Capital	Cr		
Owner introduced cash into the business						
a	Cash at Bank	Dr	\$4 000	Land	Cr	\$4 000
b	Furniture	Dr	500	Acme Furniture Co	Cr	500
c	T Singh	Dr	2 000	Furniture	Cr	2 000
d	Inventories	Dr	100	Capital	Cr	100
e	Cash at Bank	Dr	2 000	Equipment	Cr	2 000
f	J Ball	Dr	200	Cash at Bank	Cr	200
g	Cash at Bank	Dr	1 000	Loan from Bank	Cr	1 000
h	Land	Dr	100 000	Cash at Bank	Cr	10 000
				Realty Land Co	Cr	90 000
i	Cash at Bank	Dr	500	S Lee	Cr	500
j	M Henry	Dr	1 000	Cash at Bank	Cr	1 000
k	Cash at Bank	Dr	400	L Allen	Cr	400
l	Loan from Bank	Dr	500	Cash at Bank	Cr	500
m	Wages	Dr	2 200	Cash at Bank	Cr	2 200
n	T Pham	Dr	5 000	Service Fees Revenue	Cr	5 000

3.19 The following is an analysis of transactions broken into their debit and credit components. **Identify** the transactions that gave rise to the analysis.

Example: Cash at Bank Dr Service Fees Revenue Cr			
Sold services for cash			
a	Consumable supplies	Dr	A Kelt Cr
b	Office expenses	Dr	Cash at Bank Cr
c	Furniture	Dr	Office Supplies Ltd Cr
d	T Vander	Dr	Service Fees Revenue Cr
e	Cash at Bank	Dr	Interest Revenue Cr
f	Furniture	Dr	Cash at Bank Cr
g	Cash at Bank	Dr	B Freeman Cr
h	W Daunt	Dr	Cash at Bank Cr
i	Equipment	Dr	Cash at Bank Cr
j	Motor Vehicle	Dr	Capital Cr

Preparation of ledger accounts

In this section we will examine one of the most important aspects of accounting: the preparation and balancing of ledger accounts. These accounts may be analysed to gain any necessary information.

Chart of accounts

You will realise from the transactions and entries you have examined in this chapter that there are a large number of ledger accounts. The larger the business, the greater the number of ledger accounts it will have. Irrespective of the size of the business, all the people who work with the ledger accounts need a quick and simple way of identifying and locating each account. It has been found that the best system of identification uses account numbers instead of always referring to the accounts by their names. A number is shorter and more easily handled by computers. Thus, each ledger account has its own unique number. The list of all of these accounts is called a chart of accounts. A chart is a map or guide that helps people to find their way around. Navigators use a chart based on a number system (longitude and latitude) to get to their destination. In a similar way, accountants use a chart of accounts with numbers for each account. This helps them refer to and find their way around the ledger.

A chart of accounts is a list of all account titles and numbers arranged according to the classification desired in the ledger.

In this book, the ledger accounts are grouped in the order of **REALOE**:

- **R**evenues
- **E**xpenses
- **A**ssets
- **L**iabilities
- **O**wner's Equity.

Examine the chart of accounts on page 349. Note the groupings and account number system employed. This chart of accounts will be used throughout this book.

Check for understanding

- 3.20 **Analyse** the following descriptions for Capper Consulting:
- i select an appropriate name
 - ii classify each item as asset, liability, owner’s equity, expense or revenue
 - iii choose an appropriate chart of account number for each item.
 - a Amounts paid to employees for services performed.
 - b Items purchased for use in performance of services.
 - c The amount the business owes D Capper, the owner.
 - d Small change kept in cash registers.
 - e Expenses of running a vehicle.
 - f Amounts owing by the firm to suppliers.
 - g Amounts owing to the firm by customers.
 - h Amounts owing to AFG Finance Co.
 - i Tables and chairs owned by the business.
 - j Charges by the bank for keeping the business bank account.

Preparation of T ledger accounts

The procedure for entering details into the ledger is called posting.

To post to a ledger account in T format:

- 1 Identify the account and the account number, and open an account if one is not already in existence.
- 2 Identify the side of the account affected, either Dr or Cr.
- 3 Show the date of the transaction.
- 4 Fill in the Particulars column with the name of the other account(s) affected.
- 5 Place the relevant amount on the correct side.

These steps would be repeated for the other accounts affected by the transaction. Taking the first transaction from Table 3.1 on page 54, the posting would appear as follows, with each step being numbered in a purple circle:

Date	Transaction	Accounts involved	Types of account	Nature of account	Inc/Dec	Dr/Cr	Amount \$
2026							
Jan 1	Owner introduced \$20 000 cash into business	Cash at Bank	A	Dr	Inc	Dr	20 000
		Capital – W Green	OE	Cr	Inc	Cr	20 000

Dr 2				Ledger				2 Cr			
Date	Particulars	Ref	Amount \$	Date	Particulars	Ref	Amount \$				
2026				2026							
				Cash at Bank 1				No 3103			
Jan 1	Capital		20 000	double entry							
3	4		5								
				Capital – W Green 1				No 5101			
				Jan 1	Cash		20 000				
				3	4		5				

The completed ledger, in T account format, showing all the transactions in Table 3.1, appears as follows. Note that similar types of accounts are kept together.

Dr				Green Advice Ledger				Cr			
Date	Particulars	Ref	Amount \$	Date	Particulars	Ref	Amount \$				
2026				2026							
Asset accounts											
				Cash at Bank				No 3103			
Jan 1	Capital		20 000	Jan 3	Motor Vehicles		15 000				
				7	ABC Co		2 000				
				Furniture				No 3301			
Jan 5	ABC Co		4 000								
				Motor Vehicles				No 3303			
Jan 3	Cash		15 000								
Liability accounts											
				ABC Co				No 4102.1			
Jan 7	Cash		2 000	Jan 5	Furniture		4 000				
Owner's Equity accounts											
				Capital – W Green				No 5101			
				Jan 1	Cash		20 000				

Notes to ledger

If Cash at Bank is the only cash account used, it is acceptable to simply enter 'Cash' in the Particulars column, rather than the full name of the account, 'Cash at Bank'.

Because ABC is an **other payable** (not an accounts payable), its chart of accounts number begins with 4102. As it is the first other payable, it receives the number 4102.1 (see page 349).

Check for understanding

- 3.21 Using the table in Question 3.5 for Xguyen Enterprises, **prepare** the ledger using the T format.
- 3.22 Using the table in Question 3.6 for Masso & Co., **prepare** the ledger using the T format.

T account balancing

Balancing summarises all the entries in a ledger account for a period of time into one amount, at that point in time. Ledger account balancing can be done at any time, but it is typically done at the end of an accounting period, such as a month.

To balance off an account, the following steps must be carried out:

- a Add up the amounts on the debit side of the account.
- b Add up the amounts on the credit side of the account.
- c Calculate the difference between these two amounts. The difference is called the balance.
- d Place the balance on the smaller side of the account. This is called the balance carried down (balance c/d) and will make both sides equal.
- e Total both sides on the same line. These totals must be equal.
- f Bring down the balance onto the opposite side below the total. This is called the balance brought down (balance b/d) and is dated the next day. It is called a debit balance if the debit side is larger. It is called a credit balance if the credit side is larger.

Consider the following Cash at Bank account:

Cash at Bank				No 3103	
Jan 1	Capital	20 000	Jan 3	Motor Vehicles	15 000
			7	ABC Ltd	2 000

To find the balance of this account:

- a The debit side adds to \$20 000.
- b The credit side adds to \$17 000.
- c The difference is \$3000.
- d This difference is called the balance carried down and is placed on the smaller side of the account, which is the credit side in this case.
- e Both sides are totalled to \$20 000.
- f The balance is brought down on the debit side. It is a debit balance because the debit side is the larger.

The balanced Cash at Bank account would appear as follows:

Cash at Bank				No 3103	
Jan 1	Capital	20 000	Jan 3	Motor Vehicles	15 000
			17	ABC Ltd	2 000
			31	Balance c/d	3 000
		<u>\$20 000</u>			<u>\$20 000</u>
Feb 1	Balance b/d	3 000			

Note that in a T account the balance b/d is dated the first day of the next month, in readiness to start recording the next month's transactions.

Check for understanding

3.23 **Balance** the following ledger account:

Motor Vehicles				No 3303	
Jan 1	Capital	20 000	Jan 4	Cash	10 000
15	Vehicle Traders	9 000			
25	Cash	10 000			

3.24 You are given the following ledger account for M Popas.

- Balance** the ledger account.
- Explain** the nature of each entry in the ledger account.

Cash at Bank				No 3103	
Mar 1	Capital	50 000	Mar 3	Furniture	10 000
10	Service Fees	5 000	5	Motor Vehicles	20 000
15	Equipment	12 000	19	J Black	5 000
28	F Kim	9 000	22	Wages	1 600

3.25 From the following transactions for the business of J Nella, **prepare** the ledger accounts and **balance** each account.

Feb 1	Owner introduced furniture worth \$15 000 into the business.
3	Purchased furniture for \$14 000 from T Mylonas.
8	Paid T Mylonas \$14 000.
28	Purchased a vehicle for \$19 000 from F Kindt.

Preparation of columnar ledger accounts

To post to a ledger account in columnar format, the following steps must be carried out:

- 1 Identify the account and the account number concerned, and open an account if one is not already in existence.
- 2 Show the date of the transaction.
- 3 Fill in the Particulars column with the name of the other account(s) affected.
- 4 Place the relevant amount in the debit or credit column.
- 5 Calculate the running balance and place this in the balance column. Indicate whether this is a debit or a credit balance.

These steps are repeated for the other accounts affected by the transaction.
 Taking the first two transactions from Table 3.1 on page 54:

Date	Transaction	Accounts involved	Types of account	Nature of account	Inc/Dec	Dr/Cr	Amount
2026							\$
Jan 1	Owner introduced \$20 000 cash into the business	Cash at Bank	A	Dr	Inc	Dr	20 000
		Capital – W Green	OE	Cr	Inc	Cr	20 000
3	Bought vehicle for \$15 000 cash	Motor Vehicle	A	Dr	Inc	Dr	15 000
		Cash at Bank	A	Dr	Dec	Cr	15 000

The posting would appear as follows, with each step being numbered in a purple circle:

Ledger					
Date	Particulars	Ref	Debit \$	Credit \$	Balance \$
Cash at Bank ①					No 3103
2026					
Jan 1	Capital		20 000		20 000 Dr
3	Motor Vehicle			15 000	5 000 Dr
Motor Vehicle ①					No 3203
Jan 3	Cash		15 000		15 000 Dr
Capital – W Green ①					No 5101
Jan 1	Cash			20 000	20 000 Cr

To balance a columnar format ledger account, the following procedure is applied:

- a If it is the first entry in the ledger account, the balance is the same as the entry (debit or credit).
- b If there is an existing balance in the ledger account (debit or credit), add a like entry and subtract an opposite entry.

Note that, as with the T format accounts, the balance in the account is still the difference between the debit and credit 'sides' or columns of the account, and it is called a debit or credit balance depending on which is larger. Where there is no other entry in the account, and an amount is placed in a particular column, this automatically becomes the balance. After the debit entry to Motor Vehicle on 3 January, the account has a debit balance of \$15 000.

If there is already a balance in the account, the new entry must be added or subtracted to arrive at the new balance. If the new entry is placed in the same column as the nature of the balance, it is added to give the new larger balance of the same nature. If the entry is in the opposite column, it is subtracted. See how the credit entry to the Cash at Bank account on 3 January results in the balance being reduced from \$20 000 to \$5000. All this still follows the same rules you have learnt about increases and decreases, and the nature of accounts.¹

The ledger for Green Advice prepared in columnar format would appear as follows.

Green Advice Ledger						
Date	Particulars	Ref	Debit \$	Credit \$		Balance \$
Asset accounts						
Cash at Bank						No 3103
2026						
Jan 1	Capital		20 000			20 000 Dr
3	Motor Vehicle			15 000		5 000 Dr
7	ABC Co			2 000		3 000 Dr
Furniture						No 3301
Jan 5	ABC Co		4 000			4 000 Dr
Motor Vehicle						No 3303
Jan 3	Cash		15 000			15 000 Dr
Liability accounts						
ABC Co						No 4102.1
Jan 5	Furniture			4 000		4 000 Cr
7	Cash		2 000			2 000 Cr
Owner's Equity accounts						
Capital – W Green						No 5101
Jan 1	Cash			20 000		20 000 Cr

¹ An interesting point here is that occasionally an account may change its nature. If a business keeps withdrawing money from its bank account, for example, it could overdraw that account. If the bank allows this, the business could then show the bank overdraft as a liability in its Statement of Financial Position at that time, and not as the asset Cash at Bank.

You can see that one of the advantages of the columnar format is that there is an automatic running balance after every transaction, which makes answering queries about the account and the preparation of reports on profit and financial position easier. This format is particularly suitable for digital and electronic formats.

Check for understanding

- 3.26 Using the table in Question 3.6 for Masso & Co., **post** the transactions to the ledger using the columnar format. Compare this to your T form ledger, which you prepared in Question 3.22.
- 3.27 Using the table in Question 3.9 for Recyclers Inc., **prepare** the ledger in columnar format.

Trial balance

Function of the trial balance

Periodically it is useful to check the accuracy of the ledger. Usually, this would be done each month.

The reason for preparing a trial balance is to check the arithmetic accuracy of the ledger, and to ensure that double entry has taken place. It does not guarantee that the ledger is correct.

The trial balance is a list of account balances prepared on a particular date, to help check the accuracy of the ledger.

Preparation of the trial balance

The procedure for preparing a trial balance is:

- 1 Head up the trial balance.
- 2 Find the balance of each ledger account.
- 3 List each account name and put the balance in either the debit or credit column.
- 4 Total the debit and credit columns. The column totals must be equal.

Using the ledger for Green Advice, this procedure is demonstrated as follows:

Step 1 The heading for the trial balance of Green Advice is:

Green Advice			
Trial Balance as at 31 January 2026			
Account no	Account	Debit \$	Credit \$

Step 2 Find the balance of each ledger account.

- Consider the Cash at Bank account prepared previously under both the T account format and the columnar format. The Cash at Bank account has a debit balance of \$3000, so the \$3000 is placed in the debit column of the trial balance.
- When a similar balancing process has been completed with every account, the completed trial balance would appear as follows:

Green Advice				
Trial Balance as at 31 January 2026				
	Account no	Account	Debit \$	Credit \$
Step 3	3103	Cash at Bank	3 000	
	3301	Furniture	4 000	
	3303	Motor Vehicles	15 000	
	4102.1	ABC Co		2 000
	5101	Capital – W Green		20 000
Step 4			<u>\$22 000</u>	<u>\$22 000</u>

The totals of the trial balance should always be equal, because for every transaction there is a double entry (i.e. total debits equal to total credits). Remember that the trial balance is only a trial to see if the ledger is arithmetically accurate.

Note that the balance of an account normally corresponds to its nature. For example, asset accounts generally have debit balances, while liability and owner's equity accounts generally have credit balances. Revenue accounts generally have credit balances, while expense accounts generally have debit balances.

Errors not disclosed by the trial balance

Although the trial balance is a good means of checking arithmetical accuracy and double-entry rules, there are errors that the trial balance will not disclose. Some of these are:

- incorrect amounts of the same value that have been entered on both sides of the ledger
- entries of an equal amount made to the wrong side of each account
- entries of an equal amount made in the wrong accounts, but on the correct sides
- transactions omitted entirely or entered twice
- compensating errors made. These errors take many forms:
 - two errors in one account, which cancel each other out
 - two errors in the trial balance, which cancel each other out.

In spite of these shortcomings, the trial balance is still a valuable tool for checking the accuracy with which double entry has been completed. It should be done on a regular basis, especially before the preparation of final accounts and reports.

Locating trial balance errors

If the totals of the trial balance are not equal, the following steps should be carried out to locate errors:

- Re-add the trial balance.
- Check that each account has a balance of its 'normal' nature. If it does not, it could still be correct but should be examined carefully.
- Compare the balance in each ledger account with the balance shown in the trial balance to check that:
 - each balance is listed
 - each balance is listed on the correct side and with the correct amount.
- Subtract the total debit from the total credit and look for:
 - the difference; this indicates an omitted posting
 - half the difference; this indicates a posting to the wrong side of an account
 - a difference divisible by 9; this indicates a transposed figure (such as 649 instead of 946).
- Check the balance in each ledger account by:
 - re-adding the debits and credits
 - checking the subtraction to determine the account balance.
- Check all the postings back to the journal and source documents (see Chapter 4).

Check for understanding

- 3.28 **Create** a paragraph(s) on 'the trial balance'. Refer to the key attributes of a good paragraph in Chapter 1 if you need to.
- 3.29 **Identify** and give examples of three different types of errors that a trial balance will not disclose. **Explain** a procedure for discovering such errors.
- 3.30 Using the ledger in Question 3.25 for J Nella, **prepare** the trial balance.
- 3.31 Using the ledger in Question 3.26 for Masso & Co., **prepare** the trial balance.
- 3.32 **Analyse** the following transactions for Thompson Electrical (electricians) and **prepare**:
- a a T form ledger
 - b a trial balance.

Jan	1	Mandy Thompson commenced business with \$30 000.
	3	Purchased supplies for \$1500 cash.
	4	Paid wages \$1000.
	5	Performed services and received \$3400.
	9	Paid rates \$2500.
	15	Purchased supplies for \$2000 on account from Electrics Supply Co.
	21	Paid electricity account for \$400.
	28	Paid telephone account to Telstra for \$800.
	29	Service fees performed but still owing by Brandar Trading \$1300.
	30	Supplies used on the jobs \$300.

3.33 Analyse the following transactions for the service side of Sampson's Garage and **prepare**:

- a a columnar ledger
- b a trial balance.

April	1	J Sampson commenced business with \$20 000.
	3	Paid wages \$1600.
	4	Purchased lubricants used in services from Shell Oil Ltd on account \$2100.
	7	Performed services on cars for cash \$1900.
	10	Performed services on cars for \$2400 with \$300 still owing by Sam Striven.
	17	Paid wages \$1600.
	20	Paid Shell Oil Ltd \$2000.
	27	Paid electricity \$500.
	30	Lubricants used in car services \$100.

3.34 Analyse the following trial balance extract.

- a **Identify** the type of account (REALOE) for each account.
- b **Identify** the nature of each account (Dr/Cr).
- c **Identify** whether it is a debit or credit balance in the trial balance.
- d **Describe** what you notice about the nature of the account and its balance in the trial balance.

Briggs Vet Services			
Trial Balance (extract) as at 31 October			
Account no	Account	Debit \$	Credit \$
1102	Service Fees Revenue		100 000
2201	Supplies Expense	3 000	
2301	Advertising	4 000	
2407	Electricity	2 000	
2410	Office Expenses	1 500	
2413	Rates	1 000	
2421	Wages and Salaries	3 000	
3103	Cash at Bank	7 900	
3104.1	Zan Traders	1 300	
3107	Supplies	5 000	
3303	Motor Vehicle	40 000	
4101.1	Vaughan Wholesalers		2 500
5101	Capital – Z Briggs		30 000

- 3.35 Analyse** the following ledger accounts.
- a **Identify** the transaction that resulted in each posting.
 - b **Calculate** the balance of each account.

C Keane						
2026			2026			
			\$			\$
Jan 4	Cash	100	Jan 1	Office equipment	1 000	
			10	Furniture	2 000	
Cash at Bank						
2026			2026			
Mar 1	Capital	10 000	Mar 5	Furnitureland Co	100	
2	Service Fee	500	10	Equipment	1 000	
3	J Wall	200				

- 3.36 Analyse** the following transactions for J Shears, an electrician, at 28 February 2026 and **prepare**:
- a the ledger in both the columnar and T formats
 - b a trial balance.

Feb 1	J Shears commenced business with a utility car \$10 000 and tools \$5000.
4	Performed services for \$1000 cash.
7	Performed services on credit \$850 for D Nair.
10	Purchased consumable supplies \$1000 on credit from W Hardware Supplies.
12	Paid registration on utility \$150.
13	Received \$850 from D Nair.
18	Paid W Hardware Supplies \$1000.
19	Performed services \$1000 cash.
21	Purchased new tools \$200 for cash.
28	Paid \$100 to Electricians Association.
	Supplies used \$500.



3.37 Qantas Airways Ltd

Refer to the 2023 annual report for Qantas Airways by following the weblink.

Analyse the Qantas Consolidated report and answer the following questions.

- a What were the total assets at 30 June 2023?
- b What were the total liabilities at 30 June 2023?
- c What was the total amount of owner’s equity (shareholders’ equity) at 30 June 2023?
- d State the accounting equation at 30 June 2023.
- e State the accounting equation at 1 July 2022.
- f What is the revenue and other income for the financial period ended 30 June 2023?
- g How much net profit or loss was attained for the period ended 30 June 2023?

CHAPTER REVISION

3.38 Multiple choice

Complete the following multiple-choice questions by choosing the best answer.

- Which of the following statements is incorrect?
 - The accounting equation is $A = L + OE$.
 - The chart of accounts lists all assets, liabilities, owner's equity, revenue and expense accounts.
 - A general journal provides a record of transactions.
 - Trial balances do not include revenues and expenses.
- In relation to a Statement of Financial Position, which of the following statements is incorrect?
 - Assets are listed on the debit side.
 - Revenues and expenses are not listed.
 - A Statement of Financial Position is the relationship between total assets, total liabilities and total owner's equity.
 - A Statement of Financial Position lists all assets, liabilities and owner's equity at a particular point in time.
- Increases to accounts are recorded on:
 - the debit side
 - the same side as the nature of the account
 - the credit side
 - the opposite side to the nature of the account.
- 'Double entry' means:
 - for every transaction, two accounts are affected
 - for every transaction, one debit and one credit is recorded
 - two entries are made in every account
 - for every transaction, total debits equal total credits.
- Which of the following errors is disclosed by the trial balance?
 - entries made to the wrong side of each account
 - transactions omitted entirely or put in twice
 - a transaction posted to only one account
 - entries made in the wrong accounts but on the correct side
- The following are a set of transactions for the business of Esat Enterprises. There are no balances in the accounts at 1 September.

Sept	1	Sold services for cash \$1000.
	4	Purchased supplies for cash \$300.
	19	Paid wages \$500.
	23	Sold services on credit for \$5000 to M Mahoney.
	24	Paid wages \$500.
	30	Received \$250 in cash for commission.

The total of the trial balance at 30 September is:

- | | |
|-----------------|-----------------|
| A \$7550 | C \$6000 |
| B \$6300 | D \$7300 |

- 7 You are given the following trial balance (for a month) of Brown Brothers at 30 June:

Trial Balance as at 30 June			
Account number	Account	Debit \$	Credit \$
1102	Service Fees		10 000
2201	Supplies Expense	2 000	
2301	Advertising	500	
2421	Wages and Salaries	1 000	
3103	Cash at Bank	13 000	
3104.1	M Walker	3 500	
5101	Capital		10 000
		<u>\$20 000</u>	<u>\$20 000</u>

What is the net profit for the month?

- A \$20 000 C \$6500
 B \$10 000 D \$13 000
- 8 The following are a set of transactions for the business of G Iavocella. There are no balances in the accounts at 1 May.

May	1	Owner introduced \$4000 cash and furniture worth \$14 000 into the business.
	2	Purchased \$10 000 worth of supplies for cash.
	3	Performed services for \$6500 cash.
	5	Paid wages \$9000.
	13	Performed services on credit \$15 000.
	15	Received \$4000 from accounts receivable.
	25	Paid \$500 for supplies.
	31	Paid wages \$9000.

What is the balance of the Cash at Bank account at 31 May?

- A \$14 000 debit C \$10 000 debit
 B \$10 000 credit D \$14 000 credit
- 9 Which of the following transactions does not involve a revenue account?
- A Performed services of \$10 000 on credit for P Smith.
 B Purchased \$5000 worth of furniture for cash and \$3000 of supplies for cash.
 C Received commission of \$7000 and interest of \$550.
 D Services performed \$2000 for cash.
- 10 The following are a set of transactions for the business of Christensen Consulting. There are no balances in the accounts at 1 August.

Aug	1	Owner introduced \$5000 cash into the business.
	4	Purchased supplies \$12 000 from J Scanlan.
	6	Paid wages \$5000.
	19	Performed services for J Scanlan for \$2000 cash.
	23	Purchased \$14 000 motor vehicle from J Scanlan.
	31	Paid \$5000 to J Scanlan.
		Performed services for J Scanlan for \$8000.

What is the net amount owing to J Scanlan on 31 August?

- A \$13 000 credit
- B \$11 000 credit
- C \$33 000 credit
- D \$41 000 credit

3.39 Case study

Synthesise the information presented in stimuli 1 and 2 and **prepare** the complete ledger for Yuen Services in columnar format for the month of August.

STIMULUS 1 – INCOMPLETE LEDGER

Yuen Services Ledger							
Dr				Cr			
Date	Particulars	Ref	Amount \$	Date	Particulars	Ref	Amount \$
Service Fees Revenue							No 1102
				Aug 1	A Brown		200
Electricity							No 2407
Cash at Bank							No 3103
Aug 5	Service Fees		1 000	Aug 8	Electricity		100
15	A Brown		200	12	Supplies		300
				18	J Smith		25
Supplies							No 3107
Aug 10	J Smith		50	Aug 31	Supplies Expense		300
J Smith							No 4101.1

STIMULUS 2 – EXTRACT FROM CHART OF ACCOUNTS FOR YUEN SERVICES

2 Expenses

- 22 Cost of Services
- 2201 Supplies Expense

3 Assets

- 31 Current assets
 - 3104 Accounts Receivable
 - 3104.1 A Brown

4

THE ACCOUNTING PROCESS TO THE TRIAL BALANCE

LEARNING OBJECTIVES

At the end of this chapter you should be able to:

- describe the terms 'source documents' and 'journal'
- explain the steps in the accounting process
- explain the role of a source document and the various documents used to validate transactions
- synthesise accounting principles and processes to journalise basic transactions, post to the ledger and prepare a trial balance
- explain the effect of the good and services tax (GST) on the supply chain and accounting process
- synthesise accounting principles and processes to prepare a variety of general journal entries, (including those involving GST and perpetual inventories), post to the ledger and prepare a trial balance.

The accounting process to the trial balance

The accounting process

Source documents

- Need for source documents
- Examples of source documents

Journal

- Functions of a journal
- General journal
- Analysing transactions

Goods and services tax (GST)

- Registration of businesses for the GST
- Accounting and reporting for the GST

Journalising business transactions

Accounting for different types of transactions with GST

- Purchasing and using consumable supplies
- Selling services
- Paying expenses
- Purchases of inventories
- Purchases returns and allowances
- Sales of inventories
- Sales returns and allowances
- Purchase of assets other than inventories
- Sale of assets other than inventories
- Drawings of cash
- Drawings of inventories
- Correction of errors

Chapter revision

Weblinks:

- LA Times – Walter E Diemer (p.91)
- Blockchain and bitcoin (p.110)
- GST address (p.114)
- Business Activity Statement (p.115)
- Delivery of goods (p.130)



The accounting process

In Chapter 3, you were shown how to analyse any transaction and deduce its effect on asset, liability, owner's equity, revenue or expense items. You determined what accounts would be debited and what accounts would be credited; posted the transaction to the ledger; and, after all transactions for a period of time were recorded, prepared a trial balance to check the arithmetical accuracy of the records.

In this chapter, we will concentrate on the initial stages of the accounting process. You will realise the importance of source documents and understand the role of the general journal in the recording process.

Accounting records are kept continuously. However, for practical reasons – such as monitoring day-to-day operations, reporting profit and paying taxes – records are balanced and reports are prepared for various time periods. This period could be a week, month, quarter, half-year or year. At a minimum, reports would have to be prepared for each financial year, which for most businesses runs from 1 July to 30 June.

As shown in Figure 4.1, the sequence of events or steps in the accounting process used to record and report information generally is:

- 1 Prepare or collect source documents to verify that transactions have occurred.
- 2 Analyse transactions into their debit and credit elements, and enter into a journal.
- 3 Post the debit and credit elements to appropriate ledger accounts, and prepare a trial balance.
- 4 Record and post balance day adjustments.
- 5 Prepare end-of-period (month/year) financial reports.
- 6 Record and post closing entries at the end of the year.
- 7 Record and post reversing entries to allow the next yearly cycle of recording to commence.

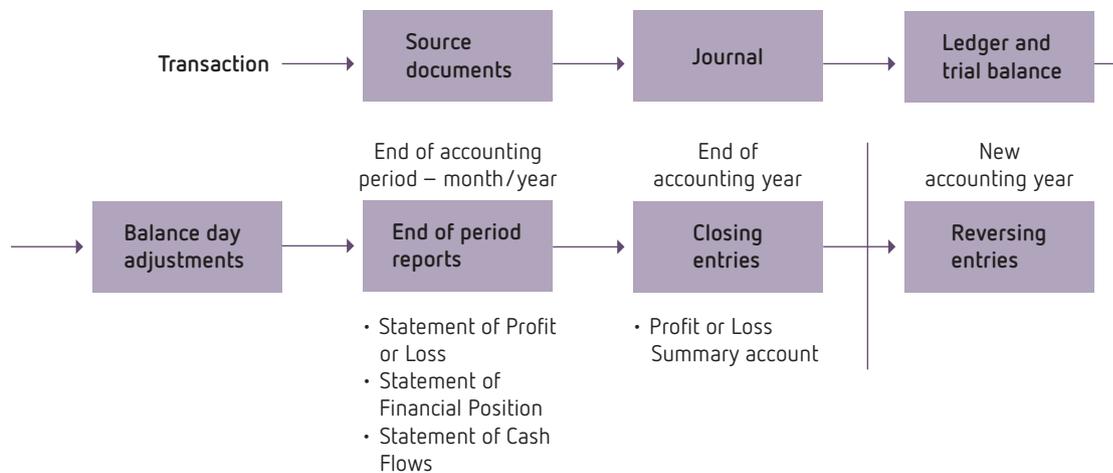


Figure 4.1 The accounting process

We have already touched on a number of these steps in learning about double entry. Now, in the next few sections, we will gradually go through each of these steps in the accounting process so that you can understand how this process results in accurate and reliable financial reports.

Before we do that, let's touch on some elements that are fundamental to accounting. These include:

- the **accounting entity concept** (discussed in Chapter 2), which separates the owner from the business for accounting purposes. This is vital as we are only accounting for the business and not the owner
- the **monetary principle**, which states that all transactions are recorded in the common monetary unit in use (dollars and cents). Thus, transactions that cannot be quantified in financial terms are not recorded in the financial reports

- the **historical cost principle**, which states that all assets are initially recorded at the amount of cash or cash equivalents paid at the time of acquisition. This means that assets, particularly long-term assets, can be recorded at their original cost for a long period of time even though the asset's value may have risen or decreased over that time period
- **materiality**, which refers to the importance of an item to the particular entity. Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial report. What is material for one entity may be immaterial for another. Judgement is important in these circumstances. Although accounting entries must be kept in an accurate fashion, the published reports may delete immaterial information. For example, cents are ignored or rounded to the nearest dollar, and even dollars may be rounded to the nearest one thousand (\$'000) or one million (\$m) dollars in larger organisations. Regardless, in the recording phase of the accounting process we are concentrating on here, all transactions must be recorded accurately, including the recording of cents
- the **going concern principle**, which requires that the business is going to continue its operations indefinitely and is not likely to be liquidated in the foreseeable future. Hence, the cost or purchase price rather than liquidation value is generally used. However, accountants recognise that when circumstances are known that make this invalid and financial reports are not prepared on a going concern basis, this must be disclosed. The reasons for the change must also be disclosed.

Source documents

In the previous chapters, the information posted to the ledger was obtained from a list of transactions. It was not stated where this information originated. In practice, the accountant must arrange to collect it, as documentary evidence of a transaction and of its nature is needed. Accounting entries are therefore usually made from source documents.

A source document provides details of a transaction and the evidence that the transaction has occurred.

Source documents vary in appearance. They may be standard printed or electronic documents (e.g. receipts, tax invoices) or less formal documents (e.g. properly authorised inter-office memoranda). They may originate in our business organisation or in another organisation, and may vary in the way they are generated and transmitted.

There are two different means of producing and transmitting source documents:

- **Manually generated.** Documents are completed by hand either by the buyer or seller, and some documentation precedes each step of the transaction. These paper-based documents must be physically transmitted to the recipient via hand, post or fax, or scanned and sent by email.
- **Computer generated (most common).** Documents are prepared by the computer. Screens similar to the document required appear, and the operator enters the appropriate data into them. The document will be stored electronically and can be printed if required at the time of the transaction or at a later date. Figure 4.2 shows a typical Reckon Accounts Plus screen for the sale of a service to a customer.

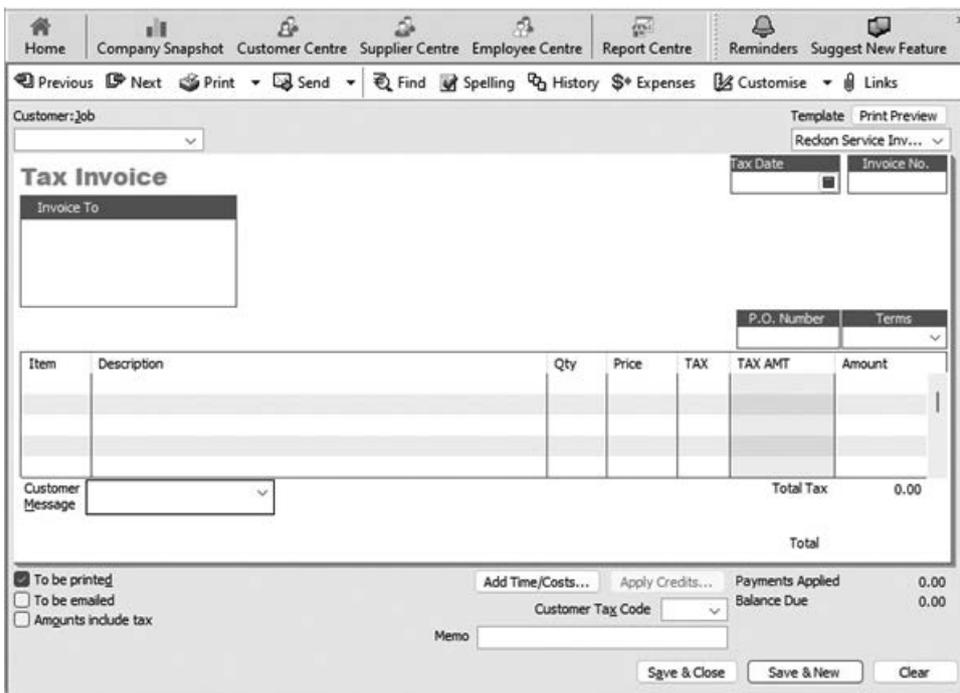


Figure 4.2 Reckon Accounts Plus

If you look across the top of the screen shown in Figure 4.2, you can see that the source document can be printed using the Print button and given to the customer; or you can click on Send to email a copy of the invoice to the customer.

As well, many transactions are conducted online, so the user is in fact the customer who completes the details on the screen and pays for the goods or service via their debit or credit card. This is shown in Figure 4.3.

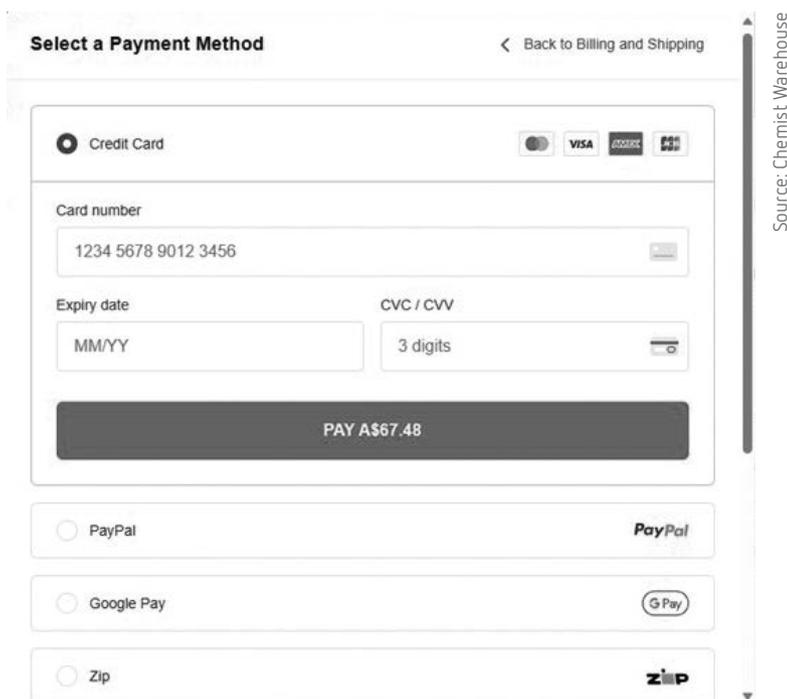


Figure 4.3 Chemist Warehouse payment screen (Note: Chemist Warehouse receives the money)

Also, a business may wish to pay debts owing to its accounts payable directly from its bank account. This could be done using cheques, but most businesses now pay through their bank's online payment system. This is illustrated in Figure 4.4.

North Bank

Make a payment

From
Account
WORKING 734-056 157294 \$12,371.62

Payer name
Wilson Enterprises

Description on your statement optional
Bracken Distributors Inv 342184

To
 Pay Anyone BPAY Transfer

Choose payee [Create new payee](#)
 Bracken Distributors – 064-192 17192615 🔍
 BSB and account numbers are used to process payments.
 No check is made of account names.

Description on their statement
 Wilson Inv342184

Details of Payment
Amount
 \$ 2300.00

Date
 02/02/2026 🇺🇸
 dd/mm/yyyy

Payment frequency
 Pay once Recurring payment

[Cancel](#) [Submit](#)

Figure 4.4 Online bank payment screen for Wilson Enterprises paying Bracken Distributors

It is important to remember that whatever document is generated, it will always have some form of identification (ID) number. This is so it can be tracked if errors occur, if there is a query about the transaction, or if the auditor requires it to verify a transaction.

Although there will always be a need for some documents to be printed, there is a move away from printing wherever possible. In larger organisations such as Woolworths and Coles, electronic transmission of documents using **Electronic Data Interchange (EDI)** is a growing trend. EDI represents the capability of one organisation (trading partner) to trade directly with another via their computer systems. It facilitates the direct transfer of business transactions and information between one

or more business partners involved in these transactions. Hence the actual printed source documents are not needed.

As well, the Internet enables small-to-medium firms to achieve the benefits of paperless trading. With the Internet as the communication medium, firms set up a **Virtual Private Network (VPN)**. Using secure connections and proper authorisation, this collaboration between business partners allows each firm to enter the information systems of the other.

Need for source documents

Source documents are extremely important because they:

- provide evidence for both internal and external auditors¹ as to the validity of transactions
- are used as the basis for entries in the accounting records
- collect and transmit information on transactions that usually occur in a section of the business different from where the accounting entries are made.

Thus, source documents collect essential data for entry into the accounting system, and provide evidence as to the validity of transactions and the financial information contained in them.

Such documents contain a number (so they can be referenced), the date, the nature of the transaction, the parties to the transaction, and the amount, terms and conditions of the transaction.

Examples of source documents

The most important source documents used in business are shown in Table 4.1.

Table 4.1 Important source documents

Source document	Evidence provided (always from our business's perspective)
Receipt (copy)	Receipt of money
Cash register docket (copy)	Receipt of money
Cash register summary	Receipt of money
Bank statement (electronic funds transfer – bank deposits)	Receipt of money
Electronic funds transfer – bank payments	Payment of money
Cheque (butt)	Payment of money
Bank statement (bank fees and charges)	Payment of money
Invoice (copy)	Credit sales of goods and services provided (no GST)
Invoice (original)	Credit purchases of items (no GST)
Journal voucher	Internal transactions and adjustments
Memo	Internal transactions and adjustments

Source documents used for recording cash receipts

Many documents can be used for recording transactions involving the receipt of cash. However, four of the most common documents are a receipt, cash register docket, cash register summary and bank statement.

¹ An internal auditor is an employee of the firm, and reports to management that the accounting system and its various components are operating as planned. An external auditor is an independent practitioner, who reports to shareholders on the accuracy of the accounting records. Any firm (sole trader, partnership or company) may employ an internal auditor, but it is a legal requirement for a public company to have its records reviewed by an external auditor.

A typical **receipt** appears in Figure 4.5. Every time a customer pays money to a business with cash or a credit/debit card, some form of receipt should be issued. The original of the receipt is given to the customer as proof that they have paid the money, and the firm retains a copy for recording purposes.

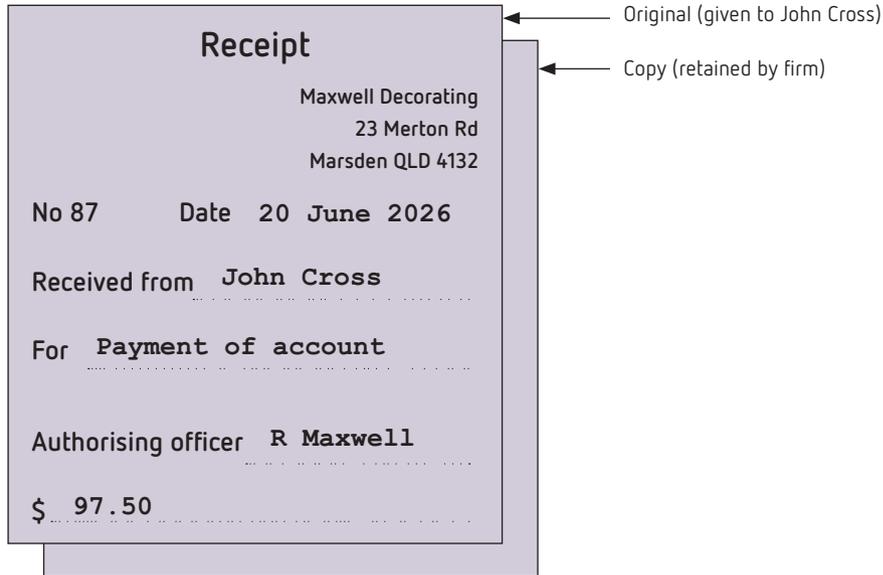


Figure 4.5 A receipt

The transaction this **receipt copy** evidenced is:

June 20	Received \$97.50 from J Cross, receipt no 87.
---------	---

The entry recorded is:

June 20	Cash at bank	Dr (Asset increasing)	97.50
	J Cross	Cr (Asset decreasing)	97.50

Another method of recording cash and card receipts is by the use of a cash register. The cash register provides two pieces of information:

- a **cash register docket**, which is given to the customer for each sale.
- a **cash register summary**, which gives a summary of each sale made on that day and a total of all sales for the day. This summary is used as the basis of cash sale entries in the records.

An advantage of using a cash register is that a summary of all transactions is available. This is useful for recording and control purposes (i.e. the reconciling of sales and other monies received with the money kept in the cash register drawer).

A cash reconciliation is done at the end of each day. This checks that the total sales (as per the cash register summary) equals the total cash in the register, plus debit or credit card receipts, minus any cash in the register at the beginning of the day (cash float). An example of a cash register reconciliation is shown in Figure 4.6. This reconciliation shows receipts of \$42 in cash (\$542 cash in register minus \$500 cash float) and receipts of \$5858.70 from debit/credit cards totalling \$5900.70.

Cash register reconciliation	
Register no 1	Date 25/6/2026
Total sales from cash register summary	<u>\$5 900.70</u>
Cash in register	542.00
Debit/credit card receipts	<u>5 858.70</u>
	6 400.70
Less Cash float	<u>500.00</u>
	<u>\$5 900.70</u>

Figure 4.6 A cash register reconciliation

The transaction this cash register summary/reconciliation evidenced is:

June 25	Service fees received \$5900.70.
---------	----------------------------------

The entry recorded is:

June 25	Cash at bank	Dr (Asset increasing)	5 900.70
	Service fees revenue	Cr (Revenue increasing)	5 900.70

The final source document that evidences receipts of money is the **bank statement**. A bank statement shows all the transactions that the bank has processed for the business's account. An example of a bank statement (extract) with typical receipts of money is shown in Figure 4.7.

Statement of Account (extract)				
ABC Bank				
Account No				
324-176				
8532 0956				
Page no 25				
Name of account Maxwell Decorating				
Date	Particulars	Debit	Credit	Balance
2026		\$	\$	\$
June 1	Balance			5 401.34 Cr
20	Deposit		97.50	5 498.84 Cr
25	Deposit		42.00	5 540.84 Cr
25	Deposit – debit/credit cards		5 858.70	11 399.54 Cr
26	Deposit Online 348294 Fernall Pty Ltd		2 810.67	14 210.21 Cr

Figure 4.7 A bank statement (extract)

You will note that this bank statement is similar to a columnar ledger, which was shown in Chapter 3. This bank statement shows that the business has a credit balance on 1 June of \$5401.34, which means that from the bank’s point of view, it is a liability. The bank owes us – Maxwell Decorating – the money and so has a credit balance. This means that we have money in the bank, and so in our records we would have a debit balance in our Cash at Bank account. When reading a bank statement, it is important to understand that it is from the bank’s perspective. Therefore deposits of money will be credited as they owe us back the money and it is increasing the bank’s liability to us.

Because we have already received cash from two sources and banked this money, we would expect to see a deposit of \$97.50, and deposits totalling \$5900.70 for service fees made up of \$42 in cash deposits by us and \$5858.70 in debit/credit card deposits by the bank. These amounts are shown in the credit column and have already been recorded by us.

However, the bank statement reveals that an accounts receivable called Fernall Pty Ltd has electronically deposited \$2810.67 into our account to pay for their debt via bank deposit no 348294. This transaction has not been recorded in our records. Therefore, the transaction this bank statement evidenced is:

June 26 Received \$2810.67 from Fernall Pty Ltd, bank deposit no 348294.

The entry recorded is:

June 26	Cash at bank	Dr (Asset increasing)	2 810.67
	Fernall Pty Ltd	Cr (Asset decreasing)	2 810.67

Many firms will treat the bank deposit number on the bank statement as the source document; if there is any dispute, the bank deposit number then evidences the transaction. However, some firms will issue a receipt for the deposit and forward this to the customer (if requested).

Source documents used for recording cash payments

In modern businesses, most payments are made electronically through the bank via electronic funds transfer (EFT). In order to make this payment, two numbers are required relating to the person or business to whom we are paying the money. The first is the BSB (Bank–State–Branch) number, which is a six-digit number identifying all bank branches in Australia (e.g. 084-223). The second is the account number at that branch of the person or business you are paying (e.g. 2173 4529). By completing the details on the bank payment screen shown in Figure 4.4 and processing the payment, a bank payment document will be produced that identifies the details of the payment. An example of a bank payment is shown in Figure 4.8.

ABC Bank				
Electronic Payment				
Payer name: Maxwell Decorating				
Payment to:				
BSB	Account Number	Account Name	Description	Amount
124001	86731900	Timmin Wholesalers	Maxwell Inv 32782	\$3 400.00
Payment Date: 27 June 2026				
Payment No: 5372913				

Figure 4.8 A bank payment

Note that under 'Description' we put our name as the person who is doing the paying (Maxwell) and the details for why we are paying the amount – in this case, invoice no 32782 from Timmin Wholesalers.

It is very important that only appropriate people have authorisation over these payments. The bank would require the bank customer number and password to be entered to gain access to the account. Further security can be provided by requiring an extra number sent by the bank via SMS or electronic token to be entered before payment is made; or, in a business situation, by requiring two people to authorise the payment.

The transaction this **bank payment** evidenced is:

June 27	Paid Timmin Wholesalers \$3400, bank payment no 5372913.
---------	--

The entry recorded is:

June 27	Timmin Wholesalers	Dr (Liability decreasing)	\$3 400
	Cash at bank	Cr (Asset decreasing)	\$3 400

A second way payments can be made is by a cheque. This form of payment is rapidly declining, but cheques are still used in some businesses. A cheque is an order made upon a bank (the drawee) to pay a stipulated amount of money to a certain person (the payee). The person who writes the cheque, or in whose name the cheque is made out, is called the drawer. An example of a cheque is shown in Figure 4.9.

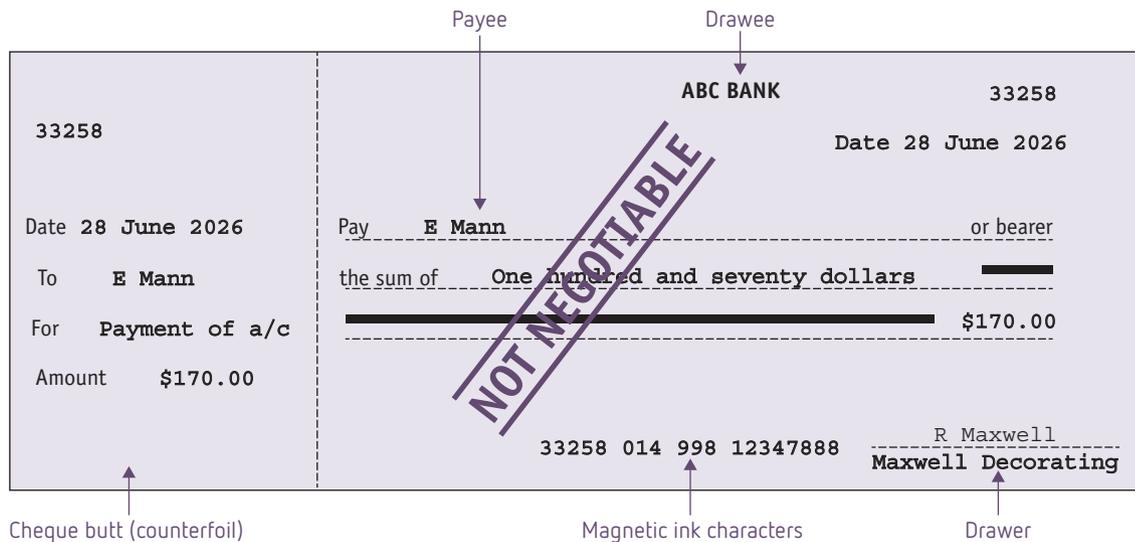


Figure 4.9 A cheque

The cheque is sent to the payee, and the drawer retains the cheque butt or duplicate copy. It is this cheque butt or duplicate that is used as the source document.

The transaction this **cheque butt** evidenced is:

<u>June 28</u>	<u>Paid E Mann \$170, cheque no 33258.</u>
----------------	--

The entry recorded is:

<u>June 28</u>	<u>E Mann</u>	<u>Dr (Liability decreasing)</u>	<u>\$170</u>
	<u>Cash at bank</u>	<u>Cr (Asset decreasing)</u>	<u>\$170</u>

The final types of payments occur when the business receives the bank statement and finds that there are legitimate payments that have been made from the bank account that the business had not yet recorded. Typical of these transactions are bank fees and charges, merchant fees for debit/credit cards, periodical payments for items such as rent, and interest paid on overdrafts/loans. An example of a bank statement (extract) with typical payments of money is shown in Figure 4.10.

Statement of Account (extract)				
ABC Bank				
Account No				
324-176				
8532 0956				
Page no 25				
Name of account Maxwell Decorating				
Date	Particulars	Debit	Credit	Balance
2026		\$	\$	\$
June 1	Balance			5 401.34 Cr
20	Deposit		97.50	5 498.84 Cr
25	Deposit		42.00	5 540.84 Cr
25	Deposit – debit/credit cards		5 858.70	11 399.54 Cr
26	Deposit Online 348294 Fernal Pty Ltd		2 810.67	14 210.21 Cr
27	Withdrawal Online 5372913 Timmin Wholesalers	3 400.00		10 810.21 Cr
30	Cheque No 33258	170.00		10 640.21 Cr
30	Bank Fee	12.00		10 628.21 Cr

Figure 4.10 A bank statement (extract)

Notice that these payments are shown in the debit column of the bank statement. From the bank’s perspective, we are withdrawing money. Therefore, these withdrawals are decreasing the bank’s liability to us and so are debited in the bank statement. Maxwell Decorating already knows about the payment to Timmin Wholesalers and the cheque payment to E Mann, and these have been recorded. However, the business did not previously know about the bank fee and so this expense must be recorded in the Bank Charges account.

The transaction this bank statement evidenced is:

<u>June 30</u>	<u>Bank charges \$12, bank statement no 25.</u>
----------------	---

The entry recorded is:

June 30	Bank charges	Dr (Expense increasing)	\$12
	Cash at bank	Cr (Asset decreasing)	\$12

An important point to note about the bank statement is that, in this instance, the cheque was written on 28 June and was presented to the bank on 30 June, and so it appeared in the bank statement. However, if E Mann put this cheque in his pocket and didn't present it to the bank for six weeks, then the bank's records and our records would be different. Such a cheque is called an **unpresented cheque**, as it has not yet been presented to the bank.

As the bank is an external party and all receipts and payments of money are processed through the bank, then our records and the bank's records should be the same. However, at any point in time there will be transactions that the bank knows about but we don't and vice versa. A **bank reconciliation** is done to reconcile our records with the bank's records. Unpresented cheques are an issue with paying by cheque. That is one of the reasons why most businesses use electronic payment. When the payment is made electronically, it is immediate. The bank reconciliation will show that if we know all the transactions that the bank has processed (bank fees and charges, EFT deposits by customers), and the bank knows all the transactions that we have processed (unpresented cheques), the balance in both sets of records will be the same. The bank reconciliation process will be covered in Chapter 6 and in *Units 3 & 4*.

Check for understanding

- 4.1 J Finlay, a painter, received cash of \$400 for painting P Nixon's business premises on 11 January 2026. Prepare receipt number 239 to record this information and **describe** the transaction for later processing in the ledger.
- 4.2 If a business has a cash register, how would the total sales for the day be reconciled with the amount of cash in the register?
- 4.3 J Wilson, an accounts receivable of S Shaw, settled a \$2000 invoice no 7290 in full on 1 May 2026 by electronically transferring the money. How would S Shaw know about this transaction? **Describe** what the source document would look like. **Describe** the transaction for later processing in the ledger.
- 4.4 On 17 January 2026, Rahal Services settled an \$870 invoice no 89212 in full by sending money via EFT to Baxter Ltd, BSB 213-892, account number 67253120, bank payment no 783256. Show how the bank payment would appear. **Describe** the transaction for later processing in the ledger.
- 4.5 Google 'RSA SecurID tokens'. **Explain** the nature of multi-factor identification.
- 4.6 On 10 June 2026, Kumar Enterprises purchased a motor vehicle from Vehicle Supplies, paying \$33 000 with cheque 72624. **Describe** the transaction for later processing in the ledger.
- 4.7 What document would be the source for bank fees and charges at 31 March 2026? What other transactions might this source reveal that may not have been recorded in our records?
- 4.8 **Explain** the purpose of a bank reconciliation.

Credit sales of goods and services (no GST) and credit purchases of items (no GST)

Whenever items are purchased or sold on credit and no goods and services tax (GST) is involved, the source document is an **invoice**. An invoice records the details relating to sales of items on credit – the name and address of the seller, the name and address of the buyer, the date, the invoice number, the details of what was sold, the total amount owed, and the terms and conditions of the sale. An example of an invoice is shown in Figure 4.11.

INVOICE			
Invoice No: 784562		Seller	
Date: 23 June 2026		Maxwell Decorating 23 Merton Rd MARSDEN QLD 4132	
Buyer			
Bandall Pty Ltd 7823 Sandler Rd KARRAPON QLD 4290			
Quantity	Description	Price	Total
	Services performed		2 178.00
TOTAL			\$2 178.00
Terms: Net payable in 7 days			

Figure 4.11 An invoice

An important point to note about invoices is that one invoice can be viewed from two perspectives. The buyer/purchaser is Bandall Pty Ltd and it will receive the original of the invoice. The seller is Maxwell Decorating and it will keep a copy of the invoice. In this case, we are doing the records of Maxwell Decorating and so we are the seller.

The transaction this **invoice copy** evidenced is:

June 23	Performed services on credit for Bandall Pty Ltd \$2178, invoice no 784562.
---------	---

The entry recorded is:

June 23	Bandall Pty Ltd (an accounts receivable)	Dr (Asset increasing)	\$2 178
	Service fees revenue	Cr (Revenue increasing)	\$2 178

If Maxwell Decorating received an **original invoice** from a supplier (e.g. Telstra, electricity authority), then it would be the purchaser of those items or services on credit. The appropriate entry would then be made to record those **purchases**.

Some businesses combine an invoice and a receipt. For example, a business that runs an X-ray clinic may require all customers to pay immediately after the service is performed. The top part of the document may be an invoice that sets out details of the service performed; and the bottom part may be the receipt for the collection of money for the service. In this instance, an invoice outlines how much is owed by the customer and the receipt indicates that it has been paid. Many computer systems operate this way. The system treats every sale as a credit sale with an invoice. The money is then received against that invoice. The only difference from the traditional system is that instead of giving the customer a number of days to pay the invoice, the terms of the invoice are immediate payment.

Note that most businesses in Australia are required to register for GST. If GST is to be collected or paid, the document is called a **tax invoice**. Tax invoices will be discussed later in this chapter.

Internal transactions and adjustments

All of the transactions covered in this section so far have been transactions with an external party. However, sometimes an internal transaction is required, such as an error correction or recording the amount of supplies and/or insurance used during the month. The most important thing is that these transactions are properly authorised. The source document can be an **internal memorandum** setting out the details of the transaction and appropriately signed. Alternatively, a document called a **journal voucher** can be used. The journal voucher sets out the name of the organisation, the date of the transaction, the journal voucher number, the accounts to be debited and credited, and appropriate authorisation. These documents are then used to enter the transaction into the accounts. An example of an internal memorandum is shown in Figure 4.12.

INTERNAL MEMORANDUM	
30 June 2026	
Maxwell Decorating 23 Merton Rd MARSDEN QLD 4132	
Supplies used during the month \$150	
Signed: R Maxwell	

Figure 4.12 An internal memorandum

The transaction this internal memorandum evidenced is:

June 30	Supplies used during month \$150, memo dated 30 June 2026.
---------	--

The entry recorded is:

June 30	Supplies expense	Dr (Expense increasing)	\$150
	Supplies	Cr (Asset decreasing)	\$150

The accounting process linking the transaction, source document and general journal will be discussed in the next section.

Interesting accounting fact

Did you know?

The inventor of bubble gum was an accountant

Bubble gum was invented by accountant Walter E Diemer in 1928.

Source: *Los Angeles Times*, <https://www.latimes.com/archives/la-xpm-1998-jan-13-mn-7854-story.html>



Weblink
LA Times –
Walter E Diemer

Check for understanding

- 4.9 In terms of the positioning of the buyer's and seller's name on an invoice, whose name goes in the top section of the invoice? Who receives the original invoice?
- 4.10 **Prepare** an invoice from the following data:

Buyer: Manjuan Industries	Invoice No: 38729
Seller: Merton Art Design	Date: 21 April 2026
Description: Services performed	Total amount: \$543
Terms: Payable in 14 days	

- 4.11 **Prepare** a journal voucher no 24 for the transaction shown in Figure 4.12.
- 4.12 Collect samples of source documents for business transactions from your daily life for a period of one week. Samples might include receipts, order forms, cheques or cheque butts, bank statements, timecards, pay advice slips, tax invoices, credit card receipts, cash register docketts, bills or statements. Decide which of these would result in entries in accounting records. Remember that entries would be made only where transactions affecting items in the ledger accounts occur. List transactions with their appropriate documents (e.g. sales – invoices, payments – cheques). Do this from a personal point of view, and from the point of view of the business from which you obtained them. Prepare a display of an interesting sample of these documents.
- 4.13 Working in groups, visit a local service business such as a beauty salon. List and **describe** the source documents that the business receives and prepares. Present your findings verbally to other groups, showing them samples and explaining what data the documents contain that are useful to the business.
- 4.14 **Explain** why a business needs to use source documents.

Journal

If the complete accounting process is followed, information about a transaction is collected on a source document; this information is then analysed and entered into a journal before being posted to appropriate ledger accounts.

A journal is the record of original entry, which collates and analyses information from source documents to facilitate posting to ledger accounts.

A journal (or 'daybook') is used to record a business's day-to-day transactions in chronological order. This recording of daily business transactions in a journal is a basic step in accounting systems.

Functions of a journal

In an accounting system, the journal provides a formal and permanent record of transactions and their analysis. When used, the journal has the following functions:

- It provides a record of transactions in date order.
- It acts as an aid for posting to the ledger by analysing the transaction into its debit and credit elements.
- It enables easy referencing – forward to the ledger, and back to the source documents.
- Although computerised accounting is often used in practice, in manual accounting specialised journals also help classify and summarise details of transactions of similar types (such as cash receipts or cash payments) and cut down on unnecessary detail in the ledger.

General journal

As its name implies, the general journal is an all-purpose journal in which any or all of a business's transactions may be recorded. In manual accounting systems, other specialised journals will be used, such as a Cash Receipts journal for all cash receipts and a Cash Payments journal for all cash payments. However, most businesses use a computer accounting package to record accounting transactions and these are recorded in the general journal. In computerised accounting systems, specialised journals are not generally used for recording purposes. As a result, throughout this book, the general journal will be emphasised.

Preparing the general journal

Entries in the general journal include the following information:

- 1 date of the transaction
- 2 titles of the accounts debited
- 3 amounts to be debited
- 4 titles of the accounts credited
- 5 amounts to be credited
- 6 an explanation for the entry, called a narration, which usually contains reference to the source document used as the basis of information for the entry.

General journal entries are always made with the debit accounts preceding the credit accounts. The credit parts of the entry are usually indented from the debit parts. For reference purposes, journal pages are numbered in consecutive order – 1, 2, 3 and so on – as each new page is begun, and a reference (consisting of the appropriate ledger account number) is included in the Ref column to show that the details have been posted to ledger accounts. An illustration of how this information appears in a general journal entry is shown in Figure 4.13.

General Journal					Page no	
Date	Particulars	Ref	Dr	Cr		
			\$	\$		
Mar 10	Title of account(s) debited Title of account(s) credited (Explanation of entry, including document reference, if applicable)	A/c no A/c no	10 000		10 000	

Figure 4.13 Two-column general journal

Check for understanding

4.15 **Explain** the meaning and functions of a journal in the accounting process.

Analysing transactions

We have already seen that every transaction affects two or more items in the financial statements. Therefore, each transaction must affect two or more accounts in the ledger. At least one of these accounts will be debited and at least one will be credited.

To analyse transactions into their debit and credit elements, you should determine the following:

- 1 What ledger accounts are involved; that is, what ledger accounts have been affected by the transactions?
- 2 What type of account is each of these; that is, are they classified as assets, liabilities, owner’s equity, revenues or expenses?
- 3 What is the nature of each account?
- 4 Is each account increasing or decreasing?
- 5 Which side of each ledger account is affected: debit or credit?
- 6 By what amount must each account be debited or credited?

Let’s analyse and journalise some typical transactions for A Hassad, who wants to start a business advisory service called BusServe.

Jan 1 Owner invested \$200 000 cash into a bank account under the name of BusServe. Receipt no 001 was completed to record this transaction.

Source document

Receipt

BusServe
764 Burent St
MARPLE QLD 4923

No 001 Date 01 Jan 2026

Received from . **A Hassad**

For **Capital investment**

.....

Authorising officer . **A Hassad** ...

\$ **200 000**

Analysis

- 1 What ledger accounts have been affected by the transaction?**
The business has received cash. Cash transactions are summarised in the Cash at Bank account. A Hassad is introducing personal funds into the business. Such owner’s investments are summarised in the account called Capital – A Hassad.
- 2 What type of account is each of these?**
Cash at Bank account is an asset account. Capital – A Hassad is an owner’s equity account.
- 3 What is the nature of each account?**
The Cash at Bank account has a debit nature. Capital has a credit nature.
- 4 Is each account increasing or decreasing?**
The Cash at Bank account is increasing. The Capital account is increasing.

5 Which side of each ledger account is affected?

As increases go on the same side as the basic nature of the account, Cash at Bank is debited. Capital has a basic credit nature and it is increasing, so it is credited.

6 What is the amount?

In this case, both Cash at Bank and Capital are increased by \$200 000. The general journal entry would therefore be:

General Journal				
Date	Particulars	Ref	Dr \$	P1 Cr \$
2026 Jan 1	Cash at Bank Capital – A Hassad (Owner commenced business by investing \$200 000 cash, receipt 001)		200 000	200 000

Note that account numbers are not normally inserted in the Ref column until the entry is posted to the ledger accounts. This helps to check that all entries and all parts of the entry are actually posted.

Jan 3 Bought motor vehicle from ABC Motors Ltd for \$35 000 on invoice no 3679, paying a deposit of \$5000 with bank payment no 764291.

Source document

INVOICE			
No 3679			
		ABC Motors Ltd 4537 Kanye St MARPLE QLD 4923	
Date: 3 Jan 2026			
To: BusServe 764 Burent St MARPLE QLD 4923			
Quantity	Description	Price	Total
1	Motor Vehicle		35 000
	Less Deposit		5 000
TOTAL			\$30 000

Western Bank				
Electronic Payment				
Payer name: BusServe				
Payment to:				
BSB	Account Number	Account Name	Description	Amount
129130	7129328	ABC Motors Ltd	BusServe Inv 3679	\$5 000.00
Payment Date: 3 Jan 2026				
Payment No: 764291				

Analysis

1 What ledger accounts have been affected by the transaction?

The business has purchased a vehicle, which it intends to keep for a long period. This would be recorded in a Motor Vehicles account. A part-payment of \$5000 has been made from the business bank account, so the Cash at Bank account is affected. \$30 000 must also be recorded as owing to ABC Motors Ltd. Thus, three accounts are affected in this transaction: Motor Vehicles, Cash at Bank and ABC Motors Ltd.

2 What type of account is each of these?

Motor Vehicles is an asset account. Cash at Bank is an asset account because money is being paid. ABC Motors Ltd is a liability account (an ‘other payable’).

3 What is the nature of each account?

As an asset, the Motor Vehicles account has a debit nature. Cash at Bank is also an asset with a debit nature. Liabilities such as ABC Motors Ltd have a credit nature.

4 Is each account increasing or decreasing?

The Motor Vehicles account is increasing. Cash at Bank is decreasing. ABC Motors Ltd is increasing from zero to \$30 000.

5 Which side of each ledger account is affected?

As increases go on the same side as the basic nature of the account, the asset Motor Vehicles is debited. Decreases go on the opposite side to the nature of the account, so Cash at Bank is credited. The liability ABC Motors Ltd is also credited, as increases go on the same side as the basic nature of the account.

6 What is the amount?

The Motor Vehicles account is increased by \$35 000. Cash at Bank is decreased by \$5000. ABC Motors Ltd is increased by \$30 000.

This analysis in table form appears as:

Date	Transaction	Accounts involved	Type of account	Nature of account	Inc/Dec	Dr/Cr	Amount \$
Jan 3	Bought motor vehicle on credit for \$35 000, paying a deposit of \$5000	Motor Vehicles	A	Dr	↑	Dr	35 000
		Cash at Bank	A	Dr	↓	Cr	5 000
		ABC Motors Ltd	L	Cr	↑	Cr	30 000

So, the general journal entry would be:

General Journal				
Date	Particulars	Ref	Dr \$	P1 Cr \$
Jan 3	Motor Vehicles Cash at Bank ABC Motors Ltd (Purchased motor vehicle on Inv 3679, paying deposit of \$5000, bank payment 764291)		35 000	5 000 30 000

Jan 15 Paid wages \$1000, bank payment no 800376.

Western Bank				
Electronic Payment				
Payer name: BusServe				
Payment to:				
BSB	Account Number	Account Name	Description	Amount
278145	16238941	Ju Chan	BusServe Wages	\$1 000.00
Payment Date: 14 Jan 2026				
Payment No: 800376				

Analysis

Date	Transaction	Accounts involved	Type of account	Nature of account	Inc/Dec	Dr/ Cr	Amount \$
Jan 15	Paid wages \$1000	Wages and Salaries	E	Dr	↑	Dr	1 000
		Cash at Bank	A	Dr	↓	Cr	1 000

So, the general journal entry would be:

General Journal				
Date	Particulars	Ref	Dr \$	P1 Cr \$
Jan 15	Wages and Salaries Cash at Bank (Paid wages, bank payment 800376)		1 000	1 000

Jan 21 Charged M Johnson \$2000 fees for services performed, invoice no 886.

INVOICE			
No 886			
Date: 21 Jan 2026		BusServe 764 Burent St MARPLE QLD 4923	
To: M Johnson 12 Went St MARPLE QLD 4923			
Quantity	Description	Price	Total
	Services performed		2 000
TOTAL			\$2 000

Analysis

Date	Transaction	Accounts involved	Type of account	Nature of account	Inc/Dec	Dr/ Cr	Amount \$
Jan 21	Charged M Johnson service fees \$2000	M Johnson (A/c rec.)	A	Dr	↑	Dr	2 000
		Service Fees Revenue	R	Cr	↑	Cr	2 000

So, the general journal entry would be:

General Journal				
Date	Particulars	Ref	Dr \$	Cr \$
Jan 21	M Johnson Service Fees Revenue (Charged service fees, invoice 886)		2 000	2 000

Jan 27 Paid ABC Motors Ltd \$2000 on bank payment no 921476.

Western Bank				
Electronic Payment				
Payer name: BusServe				
Payment to:				
BSB	Account Number	Account Name	Description	Amount
129130	7129328	ABC Motors Ltd	BusServe Inv 3679	\$2 000.00
Payment Date: 27 Jan 2026				
Payment No: 921476				

Analysis

Date	Transaction	Accounts involved	Type of account	Nature of account	Inc/Dec	Dr/ Cr	Amount \$
Jan 27	Paid ABC Motors Ltd \$2000	ABC Motors Ltd Cash at Bank	L A	Cr Dr	↓ ↓	Dr Cr	2 000 2 000

The general journal entry would be:

General Journal					P1
Date	Particulars	Ref	Dr \$	Cr \$	
Jan 27	ABC Motors Ltd Cash at Bank (Paid \$2000 to ABC Motors Ltd, bank payment 921476)		2 000	2 000	

Jan 28 Owner withdrew cash for own use \$500.

Western Bank				
Electronic Payment				
Payer name: BusServe				
Payment to:				
BSB	Account Number	Account Name	Description	Amount
153412	72130921	A Hassad	BusServe Drawings	\$500.00
Payment Date: 28 Jan 2026				
Payment No: 943289				

Analysis

Date	Transaction	Accounts involved	Type of account	Nature of account	Inc/Dec	Dr/ Cr	Amount \$
Jan 28	Owner withdrew cash for own use \$500	Drawings Cash at Bank	-OE A	Dr Dr	↑ ↓	Dr Cr	500 500

Note that whenever the owner withdraws money in a sole trader business, this is classified as a special reduction of capital and is called drawings. Because drawings is a reduction of owner's equity, it is classified as a negative Owner's Equity account and therefore has a debit nature. The chart of accounts number is 5101A. The 'A' is used to signify it is a negative item attached to another account – in this case, Capital, which is 5101.

The general journal entry would be:

General Journal				
Date	Particulars	Ref	Dr \$	P1 Cr \$
Jan 28	Drawings Cash at Bank (Owner withdrew \$500, bank payment 943289)		500	500

Jan 29	Error correction – an amount of \$3200 had been posted to the Equipment account when it should have been posted to Repairs and Maintenance Invoice 23912.
--------	---

INVOICE

No 23912

Millar Electrical Repairs
912 Horton St
MARPLE QLD 4923

Date: 29 Jan 2026

To: BusServe
764 Burent St
MARPLE QLD 4923

Quantity	Description	Price	Total \$
	Repairs to Equipment		3 200
TOTAL			3 200

Analysis

Date	Transaction	Accounts involved	Type of account	Nature of account	Inc/Dec	Dr/Cr	Amount \$
Jan 29	Error correction – Equipment to Repairs \$3200	Repairs and Maintenance	E	Dr	↑	Dr	3 200
		Equipment	A	Dr	↓	Cr	3 200

To correct the error in this instance, the process is:

- Determine which account is incorrect and take the amount out of that account. In this case, the Equipment account is incorrect so it must be decreased.
- Determine which account is correct and put the amount into that account. In this case, the Repairs and Maintenance account is the correct account so it must be increased.

Note that the accounts payable of Millar Electrical Repairs is not changed as we still owe \$3200.

The general journal entry would be:

General Journal					P1
Date	Particulars	Ref	Dr \$	Cr \$	
Jan 29	Repairs and Maintenance Equipment (Error correction)		3 200		3 200

From these transactions, you can see that for every transaction the total debit amounts equal the total credit amounts. This is called double entry. Double entry does not mean that only two accounts are affected.

Double entry means that for every transaction entered in the accounts, total debits equal total credits.

The following activities will give you practice in analysing transactions into their debit and credit elements using journal entries, and the next section will demonstrate how journals are posted to ledger accounts.

Check for understanding

4.16 **Prepare** general journal entries from the following analysis table:

Date	Transaction	Accounts involved	Type of account	Nature of account	Inc/Dec	Dr/Cr	Amount \$
Feb 5	Purchased equipment from M Jones	Equipment	A	Dr	↑	Dr	20 000
		M Jones (Accounts Payable)	L	Cr	↑	Cr	20 000
15	Paid electricity in cash	Electricity	E	Dr	↑	Dr	200
		Cash at Bank	A	Dr	↓	Cr	200
24	Charged P Peters service fees	P Peters (Accounts Receivable)	A	Dr	↑	Dr	1 450
		Service Fees Revenue	R	Cr	↑	Cr	1 450
27	Paid M Jones	M Jones	L	Cr	↓	Dr	20 000
		Cash at Bank	A	Dr	↓	Cr	20 000

4.17 **Prepare** an analysis table and general journal entries for the following business transactions for Jones & Co:

Mar 1	Owner, H Jones, introduced vehicle \$20 000 and cash \$15 000 as capital.
2	Bought furniture for \$500 from V Jones.
4	Sold vehicle to S Smith for \$20 000.
7	Paid V Jones \$500 cash.
9	Received \$20 000 from S Smith.

4.18 **Prepare** general journal entries for the following business transactions for Constant and Sons:

Nov 11	C Constant commenced business by depositing \$20 000 in the business's bank account.
12	The business bought the following assets for cash:
	Vehicle \$12 000
	Equipment \$ 3 000
	Furniture \$ 1 000
13	Bought land for \$100 000 from B Finance Co, paying \$1000 cash as a deposit and agreeing to pay the balance in regular instalments. Paid wages \$200.
20	Received cash for services rendered \$500.
30	Paid the first instalment of \$1000 to B Finance Co.

Illustrative example (no GST)

On 1 June 2026, Mandy Huang decided to open her own graphic artist business called Artiste Perfection. She had been working as an employee as a graphic artist for many years. She hoped that many of her existing clients would come to her for work, but there was no guarantee this would happen. The following are the transactions for the first month of operations.

June 1	Commenced business with \$80 000 cash (bank deposit 100714).
	Purchased furniture \$2300 (bank payment 152378).
	Purchased motor vehicle \$10 700 (bank payment 152399).
	Purchased equipment (computers, printers etc.) \$17 000 (bank payment 152412).
	Paid 12 months' insurance \$1200 (bank payment 152490).
2	Bought supplies \$700 (bank payment 162589).
	Rented very small premises for \$800 per month (bank payment 162634).
	Contacted Telstra and purchased phone and Internet bundle for \$95 per month (bank payment 162819).
	Paid for electricity \$85 (bank payment 162917).
4	Paid for advertising in local newspapers and on Internet \$650 (bank payment 173207).
	Purchased expense items for office \$375 (bank payment 173315).
	Decided to transfer excess \$30 000 to a cash investment account to earn some interest (bank transfer 175721).
8	Received \$2240 for client work (bank deposit 102591).
11	Paid wages for previous week \$1260 (bank payment 196391).
16	Received \$2130 for client work (bank deposit 121900).
18	Paid wages for previous week \$1260 (bank payment 207243).
22	Received \$2570 for client work (bank deposit 152389).
25	Paid wages for previous week \$1260 (bank payment 258424).
26	Received \$3710 for client work (bank deposit 231745).
27	Bought supplies from Ejang Supply Co \$2800 (Invoice 2751).
28	Sent account to Adam Jones for services performed \$5220 (Invoice 1).
29	Withdrew money \$4200 (cheque 27546).
30	Bank charges for month \$12 (bank statement 1).
	Supplies used during the month \$230 (journal voucher 001).
	Insurance used during the month \$100 (journal voucher 001).

You are required to:

- a prepare the general journal for all transactions
- b post to the ledger
- c prepare a trial balance at 30 June 2026.

Artiste Perfection General Journal					P1
Date	Particulars	Ref	Dr	Cr	
			\$	\$	\$
2026 June 1	Cash at Bank Capital (Commenced business, bank deposit 100714)	3103 5101	80 000		80 000
1	Furniture Cash at Bank (Purchased furniture bank, payment 152378)	3301 3103	2 300		2 300
1	Motor Vehicle Cash at Bank (Purchased motor vehicle, bank payment 152399)	3303 3103	10 700		10 700
1	Equipment Cash at Bank (Purchased computers, printers etc., bank payment 152412)	3304 3103	17 000		17 000
1	Prepaid Insurance Cash at Bank (Paid insurance, bank payment 152490)	3109 3103	1 200		1 200
2	Supplies Cash at Bank (Bought supplies, bank payment 162589)	3107 3103	700		700
2	Rent Expense Cash at Bank (Paid rent, bank payment 162634)	2414 3103	800		800
2	Telephone and Internet Expense Cash at Bank (Paid for telephone and internet, bank payment 162819)	2419 3103	95		95
2	Electricity Cash at Bank (Paid for electricity, bank payment 162917)	2407 3103	85		85
4	Advertising Cash at Bank (Paid advertising, bank payment 173207)	2301 3103	650		650
4	Office Expenses Cash at Bank (Purchased office items, bank payment 173315)	2410 3103	375		375
4	Cash Investment Cash at Bank (Transfer to Cash Investment account, bank transfer 175721)	3205 3103	30 000		30 000
8	Cash at Bank Service Fees Revenue (Service fees received, bank deposit 102591)	3103 1102	2 240		2 240

Artiste Perfection General Journal				
Date	Particulars	Ref	Dr \$	P2 Cr \$
11	Wages Cash at Bank (Paid wages, bank payment 196391)	2421 3103	1 260	1 260
16	Cash at Bank Service Fees Revenue (Service fees received, bank deposit 121900)	3103 1102	2 130	2 130
18	Wages Cash at Bank (Paid wages, bank payment 207243)	2421 3103	1 260	1 260
22	Cash at Bank Service Fees Revenue (Service fees received, bank deposit 152389)	3103 1102	2 570	2 570
25	Wages Cash at Bank (Paid wages, bank payment 258424)	2421 3103	1 260	1 260
26	Cash at Bank Service Fees Revenue (Service fees received, bank deposit 231745)	3103 1102	3 710	3 710
27	Supplies Ejang Supply Co (Bought supplies on credit, invoice 2751)	3107 4101.1	2 800	2 800
28	Adam Jones Service Fees Revenue (Performed services on credit, invoice 1)	3104.1 1102	5 220	5 220
29	Drawings Cash at Bank (Owner withdrew cash, cheque 27546)	5101A 3103	4 200	4 200
30	Bank Charges Cash at Bank (Bank charges, bank statement 1)	2502 3103	12	12
30	Supplies Expense Supplies (Supplies used, journal voucher 001)	2201 3107	230	230
30	Insurance Prepaid Insurance (Monthly insurance, journal voucher 001)	2408 3109	100	100

Note: The Ref numbers are inserted into the general journal and the ledger after each line of the general journal is posted to the ledger.

Artiste Perfection Ledger							
Dr				Cr			
Date	Particulars	Ref	Amount \$	Date	Particulars	Ref	Amount \$
2026				2026			
Revenue accounts							
Service Fees Revenue				No 1102			
				June 8	Cash at Bank	GJ1	2 240
				16	Cash at Bank	GJ2	2 130
				22	Cash at Bank	GJ2	2 570
				26	Cash at Bank	GJ2	3 710
				28	Adam Jones	GJ2	5 220
Expense accounts							
Supplies Expense				No 2201			
June 30	Supplies	GJ2	230				
Advertising				No 2301			
June 4	Cash at Bank	GJ1	650				
Electricity				No 2407			
June 2	Cash at Bank	GJ1	85				
Insurance				No 2408			
June 30	Prepaid Insurance	GJ2	100				
Office Expenses				No 2410			
June 4	Cash at Bank	GJ1	375				
Rent Expense				No 2414			
June 2	Cash at Bank	GJ1	800				
Telephone and Internet Expense				No 2419			
June 2	Cash at Bank	GJ1	95				
Wages				No 2421			
June 11	Cash at Bank	GJ2	1 260				
18	Cash at Bank	GJ2	1 260				
25	Cash at Bank	GJ2	1 260				
Bank Charges				No 2502			
June 30	Cash at Bank	GJ2	12				

▶ **Liability accounts**

Ejang Supply Co				No 4101.1
	June 27	Supplies	GJ2	2 800
Owner's equity accounts				
Capital – M Huang				No 5101
	June 1	Cash at Bank	GJ1	80 000
Drawings – M Huang				No 5101A
June 29	Cash at Bank	GJ2	4 200	

Artiste Perfection			
Trial Balance as at 30 June 2026			
Account no	Account	Debit \$	Credit \$
1102	Service Fees Revenue		15 870
2201	Supplies Expense	230	
2301	Advertising	650	
2407	Electricity	85	
2408	Insurance	100	
2410	Office Expenses	375	
2414	Rent Expense	800	
2419	Telephone and Internet Expense	95	
2421	Wages and Salaries	3 780	
2502	Bank Charges	12	
3103	Cash at Bank	18 753	
3104.1	Adam Jones	5 220	
3107	Supplies	3 270	
3109	Prepaid Insurance	1 100	
3205	Cash Investment	30 000	
3301	Furniture	2 300	
3303	Motor Vehicle	10 700	
3304	Equipment	17 000	
4101.1	Ejang Supply Co		2 800
5101	Capital		80 000
5101A	Drawings	4 200	
		<u>\$98 670</u>	<u>\$98 670</u>

Check for understanding

- 4.19 **Identify** at least 20 types of service businesses (e.g. electrician, plumber) that serve customer needs.
- 4.20 From the business events of R Shaw listed on the following page:
- prepare** an analysis table
 - prepare** general journal entries
 - post** to a T format ledger
 - prepare** a trial balance at 31 August.

Aug	9	The owner invested cash \$15 000 and equipment \$1000.
	10	Bought equipment from S Green \$500 cash.
	11	Bought furniture from J Jones \$1000.
	17	Paid \$500 to J Jones.
	23	Supplied services to A Smith for \$400.
	31	Received payment of \$400 from A Smith.

4.21 From the business events of Essa's Vehicle Repairs listed below:

- prepare** an analysis table
- prepare** general journal entries
- post** to the ledger in columnar format
- prepare** a trial balance at 30 June.

June	1	Performed services on cars for \$1000 cash.
	3	Paid wages \$1500.
	4	Purchased supplies from Ampol Ltd on account \$1000.
	7	Received rent for unused part of premises in cash \$2000.
	10	Carried out repairs to trucks, \$3500 (\$2500 for cash and \$1000 on account to Jim's Truckers).
	20	Paid Ampol Ltd \$1000.
	23	Paid wages \$1500.
	30	Paid electricity \$500.

4.22 a For the following transactions, **prepare** a general journal, **post** to the ledger in columnar format and take out a trial balance for J Shears (an electrician) at 28 February 2026.

Feb	1	J Shears commenced business with cash \$25 000, a van \$20 000 and tools \$5000. Purchased insurance for year \$720.
	4	Performed services for \$1000 cash.
	7	Performed services on account \$850 for D Nair.
	10	Purchased supplies \$500 on account from Western Hardware.
	12	Paid registration on van \$450.
	13	Received \$650 from D Nair.
	18	Paid Western Hardware \$400. The \$500 recorded on 10 Feb was incorrect and should have been \$400.
	19	Purchased new tools \$200 for cash.
	21	Performed services \$1200 cash.
	28	Paid \$175 to Electricians Association. Performed services \$800 on account for C Nugent. Cash taken by owner \$6000. Supplies used during month \$155. Insurance for month \$60.

- Why is it best practice to record a separate entry for the error on 18 February, rather than simply change the figure in the original entry?



Real-world application



Digital currencies

Blockchain is a technology that allows the recording of digital currencies. **Bitcoin** and **Ethereum** are the most commonly talked about digital currencies that have the power to reshape transactions as we know them.

CPA Australia says:

CPA Australia continues to hold the view that the accounting requirements for crypto assets should remain on the agenda of standard-setters. Presuming the exponential growth in economic activity in crypto assets over the last few years remains on the same trajectory, a proactive approach to establishing accounting principles and requirements for crypto assets will pre-empt any gaps in accounting standards before they become a critical issue.

Source: E. Lee, R. Subramanian and A. Jackson (2023), *Crypto assets – Australian stakeholders' perspectives*. AASB Research Report 20 (September 2023), p. 4.

Investigate whether the Australian Accounting Standards Board (AASB) has taken any steps towards the development of an accounting standard for digital currencies.

- 4.23** On 1 June 2026, Phillip Aranz decided to open his own computer services business called Computer Knowledge. He had been working in the software industry for many years, acquiring knowledge of the workings of many different types of software. The following are the transactions for the first month of operations.

June 1	Commenced business with \$120 000 cash (bank deposit 100125).
	Rented premises for \$1500 per month (bank payment 101218).
	Purchased phone and Internet bundle for \$120 per month (bank payment 101921).
	Paid for electricity \$140 (bank payment 102786).
	Paid 12 months' insurance \$2100 (bank payment 103614).
	Purchased furniture \$3400 (bank payment 104284).
	Purchased motor vehicle \$20 300 (bank payment 105979).
	Purchased equipment (computers, printers etc.) \$19 000 (bank payment 109288).
2	Bought supplies \$400 (bank payment 117349).
	Paid for advertising \$290 (bank payment 193290).
	Paid for office answering service to answer calls and email enquiries \$450 (bank payment 287345).
5	Transferred excess \$40 000 to a cash investment account to earn some interest (bank transfer 387299).
8	Received \$3760 for client work (bank deposit 192877).
10	Paid for fuel \$110 (bank payment 307463).
15	Received \$1290 for client work (bank deposit 210563).
22	Received \$3910 for client work (bank deposit 319340).

26	Paid for fuel \$165 (bank payment 492186).
27	Received \$1830 for client work (bank deposit 419002). Bought supplies from Elwarn Supplies \$230 (invoice 87134).
29	Sent account to Trent Ltd for services performed \$1680 (invoice 1). Withdrew money \$5100 (bank payment 539886).
30	Bank charges for month \$12 (bank statement 1). Supplies used during the month \$65 (journal voucher 001). Insurance used during the month \$175 (journal voucher 001).

You are required to:

- a **prepare** the general journal for all transactions
- b **post** to a columnar ledger
- c **prepare** a trial balance at 30 June 2026.

Goods and services tax (GST)

Previously, we learnt the basics of the accounting process. To simplify it a little, we assumed we were accounting for a small business not registered for the **goods and services tax (GST)**. In fact, most business and consumer transactions include the payment of GST.

The GST is a broad-based tax of 10 per cent on the supply of most goods and services consumed in Australia. It is designed to be collected by enterprises but eventually paid by consumers.

With GST included in the transaction, goods with a sales value of \$1000 would be invoiced to the purchaser or consumer at \$1100, with \$100 being the GST collected by the enterprise to pass on to the government. **The GST is always calculated as one-tenth of the value, or one-eleventh of the price.** The value of a good or service supplied is the GST-exclusive amount. The price is the GST-inclusive amount.

Figure 4.14 shows how the GST works. Businesses that are not the final consumer of the product pay the GST to the Australian Taxation Office (ATO) at each stage of the production process. However, they then pass the extra 10 per cent cost on to the enterprise or person who buys from them, who in turn can claim a tax credit for the amount of the GST included in the price of any acquisitions they purchase to conduct their business. The total of the tax paid to the government is always 10 per cent, no matter how many times the goods are bought or sold before they are in the hands of the consumer. However, it is always the consumer who finally pays the tax. As the goods flow from manufacturer to wholesaler to retailer, the GST is charged and input tax credits are claimed. The consumer is at the end of the supply chain and is not able to claim back any GST paid.

In Figure 4.14, the wholesaler buys the goods from the manufacturer for \$110, so the amount of the GST (1/11 of the purchase price, which is \$10) can be claimed by the wholesaler as an input tax credit and so only has to pay \$15 GST to the ATO. Similarly, the retailer buys the goods from the wholesaler for \$275, so the amount of GST (1/11 of the purchase price, which is \$25) can be claimed by the wholesaler as an input tax credit and so only has to pay \$20 GST to the ATO. Therefore, if GST applies to a product, the business can claim back 1/11 of the GST-inclusive purchase price and if the business sells that product, it must charge an extra 1/10 of the GST-exclusive selling price in GST. This is why it is important to know whether prices are GST-inclusive and GST-exclusive.

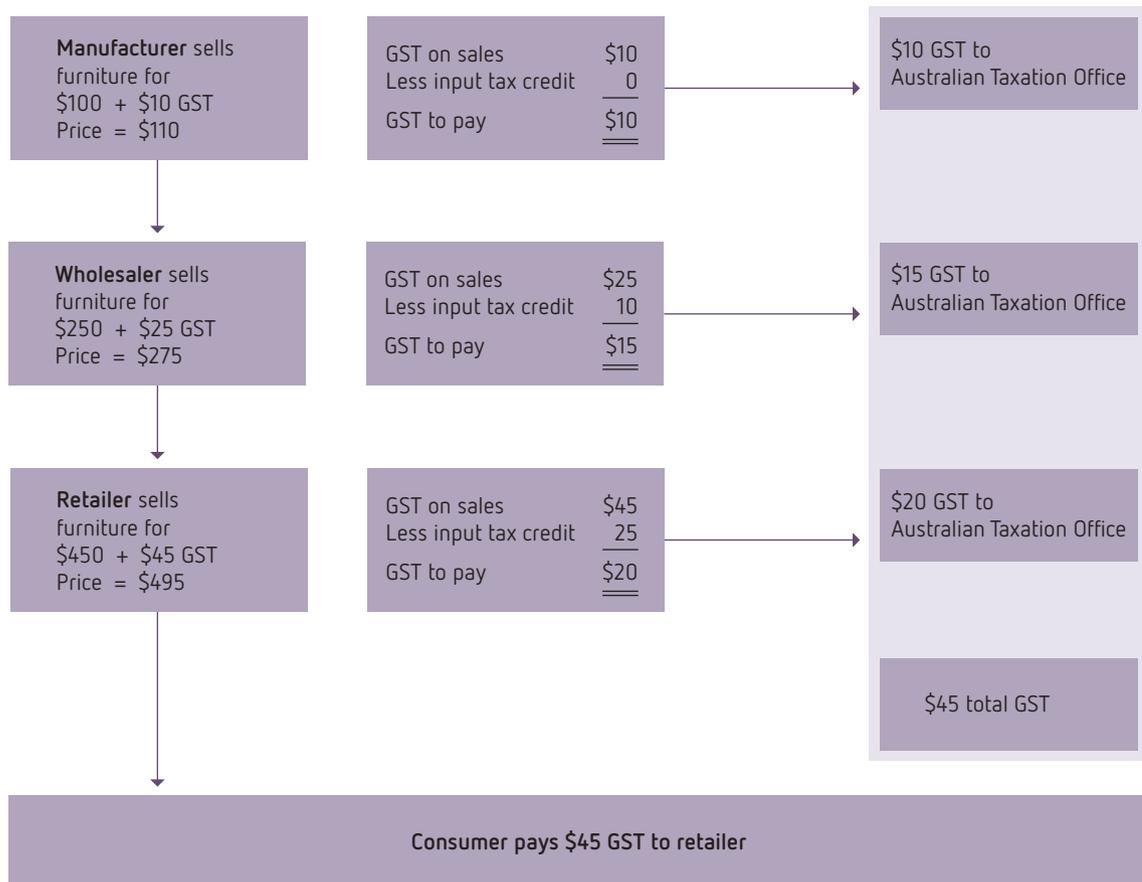


Figure 4.14 How the GST affects the supply chain

The system therefore works on the basis that supplies are taxed; and tax credits are given for acquisitions or inputs.

Under GST legislation, **supplies** are goods and services sold by an enterprise. Most supplies are taxable, but some are free of tax, while others are input taxed supplies.

- **Taxable supplies** are those goods and services that are subject to the GST. Supplies may also include other transactions, such as supplying information or advice, providing hire equipment or leasing business premises. Examples of taxable supplies include furniture, clothing, computers, stationery, telephone, electricity, food eaten in a restaurant, insurance, commercial rent, accountancy and legal fees, investment advice and taxi fares. Therefore, most goods and services fall into this category. Input tax credits can be claimed for anything that has been acquired in order to be able to supply one or more of these items.
- **GST-free supplies** are those supplies that are not taxed. They are defined by the legislation, and examples include basic food, education, water and sewerage, exports, eligible childcare, businesses bought as going concerns, non-commercial activities of charitable institutions, religious services, international air and sea travel, inwards duty-free items, international mail, grants of freehold by government, cars for use by disabled people, and most health services. Input tax credits can also be claimed for the GST included in the price of anything that was acquired in order to be able to supply one or more of these items.
- **Input taxed supplies** include financial supplies (most transactions relating to money, including interest and bank charges), sale of residential premises, residential rent, and the sale of food in school tuckshops and canteens. The GST is not charged on input taxed supplies, and input tax credits cannot be claimed for anything acquired to make the supply of these items.

The category into which most items fall is quite clear-cut, but food is one item that is much more complicated. The ATO provides a detailed food index to show which items are taxable and which are GST-free. Basic food items are generally GST-free. On the other hand, cooked, highly processed and 'luxury' items are generally taxable. Table 4.2 shows some examples of these categories.

Table 4.2 The GST status of some food items

Subject to GST	GST-free
Alcoholic beverages	Milk
Soft drink	Fruit juice
Tea and coffee, ready to drink	Tea and coffee, dry
Biscuits	Baby food
Iced buns	Bread
Cheesecake	Cheese
Confectionery	Dips
Chicken, hot cooked	Chicken, raw or cold cooked
Fruit platter	Fruit, fresh, dried or canned
Hamburgers	Ham, cold
Meat pie	Meat, raw or processed (not cooked)
Muffin, cake type	Muffin mix
Restaurant meals	Prawns, fresh, cooked cold
Seafood as prepared dinner	Seafood, fresh, frozen, dried or canned
TV dinners, frozen	Tomato sauce

Acquisitions or inputs are those goods and services bought by an enterprise in order to conduct its business activities. They include purchases of goods or services, expenses and capital expenditure items. They also include transactions such as obtaining advice or information, leasing business premises or hiring business equipment. An input tax credit can be claimed for the purchase of all taxable supplies.

Registration of businesses for the GST

Registered business entities are able to recover the GST that they pay on any acquisitions they will use in their business activities (except for input taxed supplies). Registered businesses do this by claiming **input tax credits**. When the time comes for the enterprise to meet its GST obligations, such credits will reduce the amount of GST owing. Any claim for credits must be supported by a tax invoice showing the expenditure details, but a tax invoice is not required for purchases of a GST-inclusive value of \$82.50 or less.

Input tax credits are amounts claimed back from the government for the GST paid on acquisitions used by a GST-registered business.

An entity is required to register for the GST if it is carrying on an enterprise and has, or is expected to have, an annual turnover of \$75 000 or more (\$150 000 for not-for-profit entities). However, an entity may voluntarily register for the GST if its annual turnover is less than these figures. The important point is that only registered entities are able to charge customers GST, and only registered entities are able to claim back the GST they have paid on their inputs.

To help the ATO keep track of taxation matters for business entities, an **Australian Business Number (ABN)** is used. This is a unique 11-digit identifier used by each business entity in Australia in all its dealings with the ATO. It does not replace the Tax File Number (TFN) of the entity, which must still be used on taxation forms, shareholder registration forms and so on.

You should also note that having an ABN does not automatically mean that the business is registered for the GST. The two are separate issues. However, when an entity applies for GST registration, it must also apply to the ATO for an ABN, providing details that show it to be an entity carrying on an enterprise in Australia. Thus, an entity can have an ABN without being registered for the GST, but cannot be registered for the GST without having an ABN.

A supplier who is not registered for the GST cannot charge GST on supplies made, nor claim input tax credits on the acquisition of supplies from others.

Interesting accounting fact

Did you know?

When was the GST introduced into Australia?

The goods and services tax was introduced on 1 July 2000.

Two days before the GST and its associated tax reforms commenced, Prime Minister John Howard addressed the nation on ABC Television.

Source: AustralianPolitics.com



Weblink
GST address

Check for understanding

- 4.24 **Explain** the meaning of the following terms:
- GST
 - supplies
 - taxable supplies
 - GST-free supplies
 - input taxed supplies
 - acquisitions
 - input tax credits.
- 4.25 Using the dollar amounts in Figure 4.14, **explain** the effect of the GST on the supply chain from:
- manufacturer to wholesaler
 - retailer to consumer.
- 4.26 **Identify** which businesses must register for the GST. **Describe** how they do this.
- 4.27 What identification numbers do businesses use in their dealings with the ATO? Does having these numbers mean that they are registered for the GST?
- 4.28 **a** If you are a consumer who purchases goods or services that are GST-taxable, **calculate** how much tax will you pay on goods or services for which you paid:
- \$77
 - \$1100
 - \$6886
- How much GST would you be paying if the goods or services were GST-free?
 - How much GST would you be paying if the goods or services were an input taxed supply?

- 4.29 a If you are a supplier who supplies goods or services that are GST-taxable, **calculate** how much tax must you charge on goods or services with a value of:
- i \$70
 - ii \$77
 - iii \$1100
 - iv \$6886
- b Can you claim back any input tax credits?
- i What if the goods or services were GST-free?
 - ii What if the goods or services were an input taxed supply?
- 4.30 Using three columns – Taxable supply, GST-free supply and Input taxed supply – sort the following goods and services:
- basic food
 - furniture
 - international mail
 - sale of residential premises
 - interest
 - commercial rent
 - telephone
 - bank charges
 - restaurant food
 - residential rent
 - school canteen food
 - cars for disabled
 - charities' non-commercial activities
 - exports
 - health services
 - accounting fees
 - international travel
- 4.31 To summarise the taxation status of the three types of supply, complete the following table by inserting 'Yes' or 'No' in each of the blank spaces:

Type of supply	Charge GST? (Yes/No)	Claim back input tax credits? (Yes/No)
Taxable		
GST-free		
Input taxed		

Accounting and reporting for the GST

Reporting to the government is done each tax period (monthly, quarterly or yearly, as appropriate) using a Business Activity Statement (BAS). All registered entities must lodge this return within 21 or 28 days of the end of the relevant tax period, depending on the length of this period. The BAS summarises the GST charged and collected, along with details of the input tax credits and other taxation matters for the tax period, and determines what payment (if any) must be made to the ATO. Larger enterprises (with an annual turnover of \$20 million or more) must complete their BAS and make any necessary payments on a monthly basis. Smaller enterprises with smaller turnover and lower GST and other tax commitments have more flexibility as to their tax periods, and can elect to report and pay tax instalments on a quarterly or even yearly basis. Go to the ATO weblink on Nelson MindTap to download the BAS PDF.

Of course, individuals and businesses pay many taxes other than the GST. These other taxes will not be considered at this time, but will be dealt with in later chapters.



Weblink
Business Activity
Statement

Tax invoices and other documents

As in all accounting, the concept of proper documentation is fundamental to the transaction trail of the GST. The most important documents for GST purposes are **tax invoices**. Because the GST affects most goods and services, most invoices prepared, and many cash receipts, are now tax invoices that show details of any GST included in the transaction. If a supplier makes a taxable supply, a tax invoice needs to be issued (except for transactions with a GST-inclusive value of \$82.50 or less, for which no tax invoice is required). A customer must have a tax invoice if he or she wishes to claim an input tax credit for a creditable acquisition. The tax invoice is needed before the customer can include the claim on his or her BAS. If asked by a customer for a tax invoice, a supplier is required to provide one within 28 days of the date of the request.

The tax invoice will therefore provide details of the GST on sales (and input tax credits on purchases) to include in appropriate ledger accounts. Each business can design its own invoice, so long as it provides at least the level of information required by the ATO. For example, tax invoices for supplies of \$1000 or more, as shown in Figure 4.15a, must show details such as the address or ABN of the recipient.

TAX INVOICE 3				
No 15621				
ABN 14 726 342 984 1		5 HARDWARE SUPPLIES LTD 46 MASON STREET BARKER NSW 2902		
Date: 1 May 2026 4				
To: Java Fittings 6 327 Fanton Street Barker NSW 2902 7				
Qty	Description of supply	Price	Total	
9 10	8 Doors	154.00	1540.00 2	
4	Windows	88.00	352.00	
TOTAL			\$1892.00	
The total price includes GST 10 A				

TAX INVOICE 3				
No 15621				
ABN 14 726 342 984 1		5 HARDWARE SUPPLIES LTD 46 MASON STREET BARKER NSW 2902		
Date: 1 May 2026 4				
To: Java Fittings 6 327 Fanton Street Barker NSW 2902 7				
Qty	Description of supply	Unit value	GST	Total
9 10	8 Doors	140.00	14.00	1540.00 2
4	Windows	80.00	8.00	352.00
TOTAL				\$1892.00
The total price includes GST of \$172.00 10 B				

- 1 The Australian Business Number of the entity issuing the tax invoice
- 2 The GST-inclusive price of the taxable supply
- 3 The words 'tax invoice' stated prominently
- 4 The date of issue of the tax invoice
- 5 The name of the supplier
- 6 The name of the recipient
- 7 The address or the Australian Business Number of the recipient

- 8 A brief description of each thing supplied
- 9 The quantity of goods or the extent of supplies supplied
- 10 When GST payable is exactly one-eleventh of the total price, either:
 - A a statement along the lines of 'the total price includes GST', or
 - B the GST amount.

Figure 4.15a Examples of a tax invoice for supplies of \$1000 or more

Source: Australian Taxation Office for the Commonwealth of Australia

Tax invoices for mixed supplies (i.e. where the invoice contains a mixture of taxable and either GST-free or input taxed supplies) must clearly show which items are taxed. This is usually done by the use of extra columns, or asterisks and specific statements. An example is shown in Figure 4.15b.

TAX INVOICE			
No 47945			
ABN 37 549 271 652		TORIN WHOLESALERS	
		175 MANOR DRIVE	
		TORIN QLD 4916	
Date: 1 May 2026			
To: Raynor Bros			
49 Warner Street			
Torin Qld 4916			
Qty	Description of supply	Price	Total
50	Stationery kits*	8.80	440.00
10	Fruit juice	23.00	230.00
TOTAL AMOUNT PAYABLE			\$670.00
Total includes GST of			\$40.00
* Indicates taxable supply			

- 1 Each taxable supply 2 The amount of GST payable (in relation to the taxable supplies) 3 The total amount payable for the supply.

Figure 4.15b A tax invoice for mixed supplies

Source: Australian Taxation Office for the Commonwealth of Australia

Sometimes adjustments must be made to the amount of GST that would otherwise be shown on the BAS. **Adjustments** are changes a business may need to make that will either increase or decrease the net GST payable (or refundable) for a tax period. They are categorised as either increasing or decreasing adjustments. An **increasing adjustment** is one that increases the net amount of GST payable by the entity to the ATO. A **decreasing adjustment** reduces the net amount of GST payable to the ATO.

Examples of increasing adjustments include:

- purchase returns and allowances (reducing cost of goods purchased for resale and input tax credits)
- purchase discounts received for early settlement (reducing the amount payable for goods purchased for resale and tax credits)
- recovery of bad debts written off (a debt the business did not expect is paid; GST is again owing)
- goods taken or used for owner's private purposes (the owner, the final consumer, must pay GST).

Examples of decreasing adjustments include:

- sales returns and allowances (reducing sales and GST collected and payable to the ATO)
- sales discounts allowed for early settlement (reducing the amount receivable for sales and GST collected)
- bad debts written off (a debt the business expected for sales will not be received; GST is not payable).

If an adjustment occurs in relation to a taxable supply, the customer is required to be issued with an **adjustment note**. Adjustment notes are sometimes called credit advices or credit notes. They are the opposite of the tax invoice for accounting and tax purposes, but contain similar details. They are sometimes printed in red to distinguish them from tax invoices. An example of an adjustment note is shown in Figure 4.16.

ADJUSTMENT NOTE			
No 7823			
ABN 37 549 271 652		TORIN WHOLESALERS 175 MANOR DRIVE TORIN QLD 4916	
Date: 4 May 2026			
To: Raynor Bros 49 Warner Street Torin Qld 4916			
Qty	Description of supply	Price	Total
10	Stationery kits*	8.80	88.00
TOTAL AMOUNT PAYABLE			\$88.00
Total includes GST of			\$8.00
* Indicates taxable supply Reason: Damaged			

Figure 4.16 An adjustment note

Check for understanding

- 4.32 Briefly **describe** how the tax periods for entities reporting on their tax liabilities are determined.
- 4.33 **Identify** the two main documents used to record details of transactions concerning GST. How are these different from similar documents not specifically designed to record details of GST? Who issues each of the documents, and when must they be issued? When can similar documents be issued without GST details?
- 4.34 a The next time you purchase some items from Woolworths or Coles, collect the cash docket.
- Does it display the words 'tax invoice'?
 - Does it use *, % or some other symbol to denote items that have GST?
 - Look down the list and observe those items that are GST-free and those that are taxable. From your understanding of the GST, do you think these items are categorised correctly as GST-free or taxable? Are there any items where the categorisation seems strange?
- b Each time you purchase something, you should receive a receipt (or cash docket) for paying the money. Many businesses combine a tax invoice and a receipt. Collect as many tax invoices and receipts/cash dockets as you can (from chemists, newsagents, post offices, McDonald's, KFC, Hungry Jack's, Officeworks, Bunnings Warehouse, Kmart, Target). What features are the same? What features are different?
- 4.35 a List some adjustment items that would increase the net amount of the GST payable to the ATO. Briefly **describe** why these would increase the GST payable.
- b List some adjustment items that would decrease the net amount of the GST payable. Briefly **describe** why these would decrease the GST payable.
-

Ledger and chart of accounts

The tax invoices and adjustment notes will provide the information necessary to record details of the GST. As with most areas of accounting, there are a number of alternative ways in which this information could be entered. One way is to use only one basic account – a GST account that records all GST transactions and would normally be a liability account if GST were payable. The alternative is a more detailed way of recording the GST. This method requires two basic GST accounts: one for GST collected on supplies and the other for GST credits claimed. These can then be offset against each other at the end of the period, or preferably transferred to a clearing account to determine the amount payable or refundable. This method is the one adopted in this book.

The two basic GST accounts used are:

- **GST Collected**, which is a liability for a business. It records the GST that is collected on sales and supplies, and is payable to the ATO. This account is sometimes called a GST Payable account.
- **GST Credits Received**, which is a negative liability for a business because it reduces the amount owing to the ATO. It records the input tax credits claimed on purchases or acquisitions. This account is sometimes called an Input Tax Credit Receivable account or GST Paid on Inputs account.

At the end of each period, these accounts are transferred to a **GST Clearing account**. This account can be used to calculate the net amount payable (or refundable) for the GST. For most businesses there will be GST payable to the ATO, so in most cases this will be a liability account.

As numbering systems vary from business to business, there are no set numbers in the chart of accounts for these accounts. The sample chart of accounts on page 349 shows one way of including them. The GST Clearing account can be included with the liabilities as account number 4102.1; the GST Collected account number would then be 4102.2; and the GST Credits Received account number would be 4102.2A. This last number indicates that GST Credits Received is an adjustment to a liability. It is offset against the GST Collected to determine how much is owing to the ATO.

You should now have an understanding of the basics of the GST and how it affects the accounting process. The next sections will build on this understanding, and show you how to apply it where necessary to journal and ledger entries. As you can see, many transactions will now include an element of GST, depending on whether the business is registered for the GST and if the actual transaction is one affected by it.

Check for understanding

- 4.36 **Identify** two basic accounts generally used to record GST. What types of accounts are these, and on which sides would their balances normally appear?
- 4.37 **Identify** the account used to determine the net balance of GST to pay or receive from the ATO.
-

Journalising business transactions

When journalising business transactions, you should continue to use the steps outlined earlier. Each transaction will affect two or more ledger accounts. At least one of these accounts will be debited and at least one will be credited. The steps in analysing business transactions into their debit and credit elements require you to answer the following questions:

- 1 What ledger accounts are involved?
- 2 What type of account is each of these?
- 3 What is the nature of each account?
- 4 Is each account increasing or decreasing?
- 5 Which side of each ledger account is affected?
- 6 By what amount must each account be debited or credited?

Business entities engage in many types of activities. Some are manufacturers (converting raw materials into finished products), some are service providers such as accountants and painters (supplying services to other businesses and consumers), some are trading entities (purchasing and selling inventories), some are mining operations (obtaining raw materials from the earth), some are rural enterprises (growing crops or raising animals for sale), some are clubs or charitable organisations (providing services to members and those in need), while others might engage in mixtures or variations of any of these and other activities. We will now discuss the basic transactions that apply to these businesses.

Accounting for different types of transactions with GST

Service providers sell their services for a fee in much the same way that trading enterprises sell inventories. Depending on the service, GST may be involved. Remember that financial services, health services, education and a few other services do not attract GST. However, most providers will be registered for the GST so that they can claim input tax credits for consumable supplies purchased.

Purchasing and using consumable supplies

Most entities that wish to provide services require some supplies to assist their service provision. For example, an electrician needs supplies of wire and switches, and a plumber needs pipes and glues. An asset account is maintained for these supplies and an expense is recorded when the supplies are used. Most of these consumable supplies purchased attract GST.

Consider the following:

Mar 2 Purchased supplies for \$2200 (GST-inclusive price) from Granton Ltd, tax invoice no 34129.

Three accounts are affected by this transaction: Supplies, GST Credits Received and the accounts payable Granton Ltd. Supplies is an asset account. It has a debit nature and is increasing, so it is debited for the net value of the supplies of \$2000. GST Credits Received is a negative liability. It has a debit nature and is increasing, so it is debited for the GST amount of \$200, which may be claimed back from the ATO. (Remember that, when calculating the amount of the GST, it is always one-tenth of the net amount or one-eleventh of the gross amount.) Granton Ltd is a liability account and has a credit nature. It is increasing, so its entry is recorded on the same side as its basic nature. It is therefore credited for \$2200. This is the full amount that is owed to Granton Ltd, as it will include the GST.

The entry would be:

General Journal				
Date	Particulars	Ref	Dr \$	Cr \$
Mar 2	Supplies (net) GST Credits Received (tax) Granton Ltd (gross) (Purchased supplies on tax invoice 34129)		2 000 200	2 200

Note that the bracketed words 'net', 'tax' and 'gross' are not part of the entry. They are only included to help you understand the entry.

If the supplies had been purchased for cash, the only change to the above journal entry would be to credit the Cash at Bank account, as a decreasing asset for the amount owing, rather than the Granton Ltd account.

Mar 31 Supplies used during the month \$1200 (journal voucher 912).

Notice that the amount of supplies in the asset account is \$2000, which is the net amount excluding GST. If we use these supplies, there is no GST involved as it does not affect an external party. The entry therefore does not change from what has previously been done.

General Journal				
Date	Particulars	Ref	Dr	P1 Cr
			\$	\$
Mar 31	Supplies Expense Supplies (Supplies used, journal voucher 912)		1 200	1 200

Selling services

Here is a typical transaction, where a service provider charges a fee for service:

Mar 3 Charged fees for services provided to J Brown for \$550 GST-inclusive, as per tax invoice 1001.

Three accounts are affected by this transaction: J Brown, an accounts receivable; GST Collected; and Service Fees Revenue. J Brown is an asset account with a debit nature. Because Brown owes more, Brown's account is increasing, and it will be debited. Brown must pay the value of the goods plus the GST, so the amount involved is the gross amount of \$550. GST Collected is a liability, as the owner will have to pay this to the ATO. It has a credit nature and is increasing, so the entry goes on the same side as the basic nature of this account. GST Collected is therefore credited with \$50. Service Fees Revenue is a revenue account. It has a credit nature and is increasing, so the entry goes on this same credit side for the net value of the services – \$500.

The general journal entry will be:

General Journal				
Date	Particulars	Ref	Dr	P1 Cr
			\$	\$
Mar 3	J Brown (gross) GST Collected (tax) Service Fees Revenue (net) (Charged fees for services as per tax invoice 1001)		550	50 500

If the fees had been received in cash, the only change to the above entry would have been to debit Cash at Bank account, as an increasing asset, rather than J Brown.

Paying expenses

Businesses incur many types of expenses in order to operate from day to day. Most of these are services provided by other businesses. Scan the list of expense accounts in the chart of accounts on page 349 and you will see many examples. Advertising, Accounting Fees, Bank Charges, Wages and Salaries, and Telephone Expenses are typical. Some are paid for in cash, while others are purchased on credit. Some services purchased or expenses paid do not involve GST, such as bank charges and wages and salaries. Telephone expenses are an example of a service involving GST that is commonly purchased by most businesses:

Mar 4 Paid telephone expenses of \$264, as per bank payment 870214.

Because GST is paid as part of this bill, three accounts are involved: Telephone Expenses, GST Credits Received and Cash at Bank. Telephone Expenses is an increasing expense account. It is debited with the net amount of the expense – \$240. The business will be able to claim an input tax credit for the \$24 GST included in the telephone bill, so GST Credits Received is debited for this amount as an increasing negative liability. The Cash at Bank account is a decreasing asset, so its entry for the gross amount paid of \$264 will be recorded on the credit side.

The entry will be:

General Journal				
Date	Particulars	Ref	Dr \$	Cr \$
Mar 4	Telephone Expenses (net) GST Credits Received (tax) Cash at Bank (gross) (Paid telephone expenses with bank payment 870214)		240 24	264

If such services had been purchased on credit, the only change to the above entry would have been to credit an account payable, as an increasing liability, rather than crediting the Cash at Bank account.

Illustrative example

Record the following transactions in the general journal of Jacobs Painting. Post to the ledger and prepare a trial balance.

2026	
May	2 J Jacobs took over existing business with the following assets and liabilities: cash at bank \$15 000, motor vehicle \$20 000, equipment \$4000, accounts Payable – P Patrick \$500.
4	Purchased consumable supplies for \$550 GST-inclusive, from Paint Supplies Ltd, as per tax invoice 8801.
11	Paid advertising expenses of \$660, as per bank payment 100216.
23	Charged fees for services provided to J Johnson for \$825 GST-inclusive, as per tax invoice 5001.
30	Charged fees to M Garney of \$440 GST-inclusive, receiving payment in full, bank deposit 156214.
31	Supplies used \$400.

The completed general journal would appear as follows:

Jacobs Painting General Journal				
Date	Particulars	Ref	Dr \$	Cr \$
May 2	Cash at Bank	3103	15 000	
	Motor Vehicle	3303	20 000	
	Equipment	3304	4 000	
	P Patrick	4101.1		500
	Capital – J Jacobs	5101		38 500
	(Commenced business with assets and liabilities)			
4	Supplies	3107	500	
	GST Credits Received	4102.2A	50	
	Paint Supplies Ltd	4101.2		550
	(Purchased supplies as per tax invoice 8801)			
11	Advertising	2301	600	
	GST Credits Received	4102.2A	60	
	Cash at Bank	3103		660
	(Paid advertising as per bank payment 100216)			
23	J Johnson	3104.1	825	
	GST Collected	4102.2		75
	Service Fees Revenue	1102		750
	(Charged service fees as per tax invoice 5001)			
30	Cash at Bank	3103	440	
	GST Collected	4102.2		40
	Service Fees Revenue	1102		400
	(Charged service fees as per bank deposit 156214)			
31	Supplies expense	2201	400	
	Supplies	3107		400
	(Supplies used, memorandum 31 May)			

Note that the entry on 30 May is a cash entry, not a credit entry. No account is opened for M Garney. Remember that account numbers in the Ref column are entered as the journal entry is posted to the ledger.

The completed ledger would appear as follows:

Jacobs Painting Ledger							
Dr				Cr			
Date	Particulars	Ref	Amount \$	Date	Particulars	Ref	Amount \$
2026				2026			
Revenue accounts							
Service Fees Revenue				No 1102			
				May 23	J Johnson	G1	750
				30	Cash at Bank	G1	400
Expense accounts							
Supplies Expense				No 2201			
May 31	Supplies	G1	400				

				Advertising		No 2301	
May 11	Cash at Bank	G1	600				
Asset accounts							
				Cash at Bank		No 3103	
May 2	Capital	G1	15 000	May 11	Advertising and GST	G1	660
30	Service Fees and GST	G1	440				
				J Johnson		No 3104.1	
May 23	Service Fees and GST	G1	825				
				Supplies		No 3107	
May 4	Paint Supplies Ltd	G1	500	May 31	Supplies Expense	G1	400
				Motor Vehicle		No 3303	
May 2	Capital	G1	20 000				
				Equipment		No 3304	
May 2	Capital	G1	4 000				
Liability accounts							
				P Patrick		No 4101.1	
				May 2	Capital	G1	500
				Paint Supplies Ltd		No 4101.2	
				May 4	Supplies and GST	G1	550
				GST Collected		No 4102.2	
				May 23	J Johnson	G1	75
				30	Cash at Bank	G1	40
				GST Credits Received		No 4102.2A	
May 4	Paint Supplies Ltd	G1	50				
11	Cash at Bank	G1	60				
Owner's Equity accounts							
				Capital – J Jacobs		No 5101	
				May 2	Sundry accounts	G1	38 500

Posting these journal entries to the ledger is a little more complicated than most of those dealt with previously. Generally, it is the Particulars column that can cause some confusion.

Remember that, where there is only one debit and one credit in the entry, the opposite account name is placed in the Particulars column of each account. If there are two debits or credits, both opposite accounts should be cross-referenced in the Particulars column. However, to save time and space, these may be abbreviated. Where large numbers of accounts would have to be listed, the words 'Sundry accounts' are normally used instead of a detailed listing. 'Sundry' simply means 'a number of'. Note how this is used in the Capital account, instead of listing all the assets and liabilities that comprise this capital figure.

It should also be noted that the correct cross-reference in the Particulars column for liabilities included in the opening entry, such as P Patrick, is 'Capital', as it is the difference between assets and liabilities that gives us the capital figure.

The trial balance is prepared by listing the balances of the accounts. This checks that the ledger is arithmetically accurate and that double entry has taken place.

Jacobs Painting			
Trial Balance as at 30 May 2026			
Account no	Account	Debit \$	Credit \$
1102	Service Fees Revenue		1 150
2201	Supplies Expense	400	
2301	Advertising	600	
3103	Cash at Bank	14 780	
3104.1	J Johnson	825	
3107	Supplies	100	
3303	Motor Vehicle	20 000	
3304	Equipment	4 000	
4101.1	P Patrick		500
4101.2	Paint Supplies Ltd		550
4102.2	GST Collected		115
4102.2A	GST Credits Received	110	
5101	Capital – J Jacobs		38 500
		<u>\$40 815</u>	<u>\$40 815</u>

If both sides of the trial balance are equal, we can be reasonably sure that our ledger is arithmetically accurate and that double-entry accounting has been followed. If the totals were not equal, we would go through the procedure previously outlined in Chapter 3 on page 72 to find where any errors have been made.

Check for understanding

- 4.38 From the trial balance for Jacobs Painting shown above, **calculate** how much is owed to the ATO for GST. How did you calculate this figure?
- 4.39 **Record** the following transactions in the general journal of B Vincenzo, Electrician. **Post** to the ledger in T format and **prepare** a trial balance at 30 June.

June	1	Commenced business with the following assets: cash at bank \$5000, motor vehicle \$30 000 and equipment \$5000.
	5	Purchased consumable supplies for \$605 GST-inclusive, from Robins Electrical Wholesalers, as per tax invoice 5501.
	14	Paid electricity of \$88, as per bank payment 100026.
	22	Charged fees for electrical services provided to J Brown for \$1650 GST-inclusive, as per tax invoice 001.
	26	Paid to purchase consumable supplies for \$770 GST-inclusive, bank payment 100247.
	30	Cash received for fees for services provided, \$484 GST-inclusive, bank deposit 174926.
	30	Supplies used \$1000.

4.40 Record the following transactions in the general journal of Chino Plumbing. **Post** to the ledger in columnar format and **prepare** a trial balance.

July	1	F Chino took over existing business with the following assets and liabilities: cash at bank \$2000, motor vehicle \$20 000, accounts payable – Plumbers Warehouse \$500.
	4	Purchased supplies for \$550 GST-inclusive, from Plumbers Warehouse, as per tax invoice 501.
	11	Paid advertising expenses of \$770, as per bank payment 197416.
	21	Charged fees for services provided to N Monday for \$1100 GST-inclusive, as per tax invoice 5001.
	25	Paid wages \$1360, bank payment 201496.
	28	Charged fees of \$220 GST-inclusive, receiving full payment, bank deposit 179216.
	31	Paid Plumbers Warehouse \$750 on account, bank payment 204694.
	31	Supplies used \$475.

Purchases of inventories

The main difference between accounting for service entities and accounting for trading entities is the need to account for inventories of goods to be sold. Trading entities purchase inventories/stock with the express intention of reselling that product at a profit. Inventories can take many forms: a greengrocer has fruit and vegetables as inventories; a corner store sells food, groceries and household items; a motor dealer has inventories of motor vehicles; and a petrol station has fuel as inventories.

The **perpetual inventory system** is recognised as the best system of maintaining records for inventories because it provides much greater control over this asset, and allows costly and time-consuming physical stocktakes² to be reduced to a minimum. The perpetual system keeps the stock records up to date on a continuous basis, instead of merely updating the records at the end of each period. Because of the ease with which computers can handle the detailed recording required to keep track of the cost price of each and every inventory item sold, most enterprises now adopt this system, and it is the main system that will be used in this book.

The main ledger accounts needed to maintain perpetual inventory records are:

- an Inventories account
- a Cost of Goods Sold account.

The **Inventories account** is an asset account. It has a debit nature and balance. Increases because of inward movements of goods (due either to purchases or to goods being returned to the business) are recorded on the debit side. Decreases because of outward movements of goods (due either to sales or to being goods returned to other businesses) are recorded on the credit side. All of these transactions are recorded in terms of **cost price**.

The **Cost of Goods Sold** account is an expense account, so it has a debit nature. It keeps a continuous record of all **costs** associated with the inventories sold. As sales are made, the cost (or expense) of the goods sold is recorded as an increase on the debit side. If inventories are returned, this expense account must be credited (as the inventories have not really been sold and the expense has not really been incurred). How the cost is determined will be shown in Chapter 5.

Purchasing inventories is one transaction that, for most businesses, includes an element of GST. In GST terms, purchases are an acquisition. Because of GST, businesses affected must pay more than the actual

² Stocktaking is the process of listing, counting and valuing unsold inventories on hand. This is discussed further on page 187.

value of the inventories purchased. But they will then get a tax credit for GST paid on the purchase to offset against any GST they have collected on behalf of the ATO.

Examine the example below:

Mar 4 Nugun Industries purchased goods from Cronder Wholesalers for \$770 including GST, on tax invoice number 901.

Three accounts are affected here: Inventories, GST Credits Received and the accounts payable, Cronder Wholesalers. The Inventories account is an asset account with a debit nature. Because goods are coming in, it is increasing. The account is therefore debited with the net value of the purchase excluding GST, which is \$700. The GST Credits Received account is an increasing negative liability account, being the amount of the tax credit entitlement for the GST paid by the purchaser, and reducing the amount owing to the ATO. It too is debited. The accounts payable account for Cronder Wholesalers is a liability. Because it is increasing, it must be credited to increase the amount owing. It is increased by the gross amount, inclusive of GST, which is \$770, as this is the total amount owed.

The entry would be:

General Journal				
Date	Particulars	Ref	Dr	P2 Cr
			\$	\$
Mar 4	Inventories (net) GST Credits Received (tax) Cronder Wholesalers (gross) (Purchased GST-inclusive inventories on invoice 901)		700 70	770

Note that tax invoices recorded in our records for purchases would not normally be in consecutive order, as they are received from a number of different suppliers. However, for ease of reference, some firms do renumber consecutively their tax invoices received.

If the purchase of inventories had been for cash, the only change to the above entry would have been to credit the Cash at Bank account, instead of accounts payable. Cash at Bank would be a decreasing asset.

Purchases returns and allowances

If goods are damaged or otherwise unsatisfactory, they may be returned or an allowance given for them. Sometimes an allowance may also be given if returnable containers or special packaging are returned to the seller. An adjustment note, returns voucher or credit note is then prepared by the seller, and the original sent or given to the purchaser. Again, these adjustment notes would not be in consecutive order, because they are received from different suppliers, but some firms may renumber them consecutively.

Consider the following transaction:

Mar 5 Returned goods to Cronder Wholesalers, receiving adjustment note 1864 for \$220, including GST.

The effect of this entry is the opposite of that for purchases of inventory. The same three accounts are affected: Inventories, GST Credits Received and Cronder Wholesalers. However, in this case, the Inventories account is credited with \$200 because it is an asset being decreased, as inventory is returned to the supplier. The GST Credits Received account is also credited because it is a negative liability that is decreasing. Nugun can no longer claim the input tax credit of \$20. Remember, this is always

one-tenth of the net amount or one-eleventh of the gross amount. The accounts payable account for Cronder Wholesalers is debited with the gross amount of \$220, because these returns decrease the amounts owing by Nugun to Cronder. Decreases to liabilities are debited.

The accounting entry in the general journal would therefore be:

General Journal				
Date	Particulars	Ref	Dr \$	P2 Cr \$
Mar 5	Cronder Wholesalers (gross) GST Credits Received (tax) Inventories (net) (Purchases returns as per adjustment note 1864)		220	20 200

If the purchases had been returned for a cash refund, the only change would have been to debit Cash at Bank to show the cash received increasing this asset account, rather than debiting Cronder as a decreasing liability. If the goods had been exchanged or replaced, no entry generally would be necessary in the purchaser's books.

Check for understanding

4.41 a Complete the following table relating to inventories:

Nature/name of business	Inventories traded
i Officeworks	
ii KMart	
iii Woolworths	
iv Aldi	
v JB Hi-Fi	
vi Jeweller	
vii Petrol station	
viii Chemist	
ix Car dealer	
x Florist	
xi Greengrocer	
xii Small corner store	
xiii Music shop	
xiv Hardware store	
xv Pet shop	
xvi Delicatessen	
xvii Newsagent	
xviii Car accessories	
xix Garden centre	
xx Sport store	

- b What inventories would a baker have?
- c What is the name of the ledger account used for a motor vehicle purchased by a business that does not trade in motor vehicles? Is this an asset account or an expense account?
- d What is the name of the ledger account used for furniture purchased by a business that trades in furniture? Is this an asset account or an expense account?

4.42 Record the following entries in a general journal for Tennyson Traders:

Mar 13	Purchased goods from Realltime Ltd for \$825 including GST, on tax invoice 8795.
15	Received adjustment note 1934 from Realltime Ltd for goods returned to the value of \$55 GST-inclusive.
16	Purchased goods \$957 including GST, using bank payment 123325.
18	Received adjustment note and bank deposit 474982 for return of \$44 worth of goods purchased on 16 March.

Sales of inventories

Remember that, in GST terms, sales of inventories are regarded as a supply, so GST will generally be collected for later payment to the ATO.

Under the **perpetual inventory system**, sales of inventories have two separate elements in the transaction:

- the revenue or selling price element
- the expense or cost price element.

The cost price is obtained from detailed stock item records. This will be explained more fully in Chapter 5.

In effect, two separate entries must be made to record each sale. Consider the following transaction:

Mar 7	Nugun Industries sold goods on tax invoice 1001 to M Jones for \$600 with a 10 per cent GST to be added. The cost price of these goods was \$420.
-------	---

To record the selling price element of the transaction, three accounts are affected: an accounts receivable account for M Jones, GST Collected, and Sales. Even though the real (net) value of the sale is \$600, Nugun has to collect the GST-inclusive (gross) price from Jones. M Jones is an asset account that is increasing. M Jones would therefore be debited for the gross amount of \$660. The GST Collected account is a liability with a credit nature. Because of this sale, the amount owing to the government for GST would be increased by \$60. The entry is therefore made on the same side as the account's basic nature. The Sales account is a revenue account with a credit nature. As it is increasing, it would be credited with the net value of the sale (excluding GST), which is \$600.

The **selling price element of the transaction** would therefore be recorded as follows:

General Journal					P2
Date	Particulars	Ref	Dr \$	Cr \$	
Mar 7	M Jones (gross)		660		
	GST Collected (tax)			60	
	Sales (net)			600	
	(Sold GST-inclusive inventories as per tax invoice 1001)				

If the sale of inventories had been made for cash, the only change would have been to debit Cash at Bank account, as it would have been the asset that was increased, not the accounts receivable for M Jones.

To record the cost price element of the transaction, the two accounts affected are Cost of Goods Sold and Inventories. When inventories are sold, the Cost of Goods Sold account is debited to show an increase in expenses of \$420. At the same time, the value of inventories on hand must decrease, as the goods sold are taken out of stock. Therefore the asset account Inventories, which has a debit nature, must be credited with \$420.

The cost price element of the transaction would be recorded as follows:

General Journal					P2
Date	Particulars	Ref	Dr	Cr	
			\$		\$
Mar 7	Cost of Goods Sold Inventories (Cost of goods sold on tax invoice 1001)		420		420

Real-world application



Delivery of goods by drones and robots

Australia Post has invested more than a billion dollars in the past three years in new parcel processing facilities, scanning technologies and expanding its electric delivery fleet ... But some experts say the future of post lies in technological change – from warehouse automation to drone and footpath robot delivery ...

Follow the weblink to read a short article. Have drones and robots been implemented by Australia Post?

Two companies that did not keep pace with technology were Nokia and Kodak. What technology did these companies fail to keep pace with?

Source: Cosmos Magazine, *Parcel delivery by postie, drone or footpath robot?*, Petra Stock, 19 April 2023: <https://cosmosmagazine.com/news/parcel-delivery-by-postie-drone-or-robot/>



Weblink
Delivery of
goods article

Sales returns and allowances

Sales returns obviously have the opposite effect of a sale in the accounting records. Sales returns transactions consist of two parts and involve a GST adjustment, if GST was included in the original sale. Consider the following transaction:

Mar 8	M Jones returned goods, recorded on adjustment note 101 for a total amount of \$110, including GST. The cost price of these goods was \$70.
-------	---

To record the selling price element of the transaction, three accounts are again affected. Two are the same as for the sale: the accounts receivable account for M Jones and the account for GST Collected. Most firms do not enter sales returns directly into the Sales account, however. To help them monitor customer satisfaction (or dissatisfaction) and discover problems with inventory items or particular departments, they usually record sales returns and allowances in a separate account named Sales Returns and Allowances. This is a decreasing adjustment to sales, which means it is a decrease to revenues, and is therefore a negative revenue item. Its chart of accounts number would be 1101A. It therefore has a debit nature. As the Sales Returns and Allowances account is a negative revenue that is being increased, it would be debited. The amount involved is the net value

of the sales return (i.e. excluding GST), which is \$100. The GST Collected account is a liability account, with a credit nature. Because of the sales return, the amount of the sale has decreased, and the amount owing to the government for GST would be decreased by \$10. A decreasing liability is debited, as the entry is made on the opposite side to its basic nature. M Jones is an asset account that is decreasing as the sales return now means Jones owes Nugun Industries less. M Jones would therefore be credited. The adjustment to this account receivable would be for the gross amount of \$110.

The selling price element of the transaction would therefore be recorded as follows:

General Journal				
Date	Particulars	Ref	Dr \$	P2 Cr \$
Mar 8	Sales Returns and Allowances (net)		100	
	GST Collected (tax)		10	
	M Jones (gross)			110
	(M Jones returned GST-inclusive goods as per adjustment note 101)			

If the sale of inventories and their return had been made for cash, the only change would have been to credit the Cash at Bank account, as that would have been the asset decreased, not the accounts receivable for M Jones.

To record the cost price element of the transaction, the two accounts affected are Inventories and Cost of Goods Sold. When inventories are returned, the value of inventories on hand must increase, as the goods are returned to stock. Therefore the asset account Inventories is debited with \$70. At the same time, the Cost of Goods Sold account is credited to show a decrease in expenses of \$70, as the goods were not ultimately sold.

The cost price element of the transaction would be recorded as follows:

General Journal				
Date	Particulars	Ref	Dr \$	P2 Cr \$
Mar 8	Inventories		70	
	Cost of Goods Sold			70
	(Cost of goods returned on adjustment note 101)			

Check for understanding

4.43 Record the following entries in the general journal for Paraha Products:

- | | |
|--------|---|
| Aug 23 | Sold goods with a cost price of \$500 to Frank and Co for \$990 including GST, on tax invoice 1479. |
| 25 | Sent adjustment note 1934 for \$88 GST-inclusive to Frank and Co for goods returned with a cost price of \$50. |
| 26 | Sold goods with a cost price of \$150 for \$275 including GST, bank deposit 159247. |
| 28 | Sent adjustment note and submitted bank payment no 872914 for \$55 for return of goods with a cost price of \$30. |

Illustrative example

Record the following entries in the general journal for J J Electrical Wholesalers. Post to the ledger and prepare a trial balance at 31 December 2026.

Dec 1	Purchased goods from General Electric for \$1870 including GST, on tax invoice 443.
3	Received adjustment note 166 from General Electric for returns to the value of \$220 GST-inclusive.
15	Sold goods with a cost price of \$400 for \$770 including GST, bank deposit 192614.
22	Purchased goods for \$550 GST-free, bank payment 569151.
28	Sold goods with a cost price of \$1456 to M Viviani for \$1650 including GST, on tax invoice 444.
31	Sent adjustment note 343 for \$165 GST-inclusive to M Viviani for goods returned with a cost price of \$130.

JJ Electrical Wholesalers					P6
General Journal					
Date	Particulars	Ref	Dr	Cr	
			\$	\$	
2026					
Dec 1	Inventories	3106	1 700		
	GST Credits Received	4102.2A	170		
	General Electric	4101.1		1 870	
	(Purchased GST-inclusive inventories on tax invoice 443)				
3	General Electric	4101.1	220		
	GST Credits Received	4102.2A		20	
	Inventories	3106		200	
	(Purchases returns as per adjustment note 166)				
15	Cash at Bank	3103	770		
	GST Collected	4102.2		70	
	Sales	1101		700	
	(Sold GST-inclusive inventories, bank deposit 192614)				
15	Cost of Goods Sold	2105	400		
	Inventories	3106		400	
	(Cost of goods sold, bank deposit 192614)				
22	Inventories	3106	550		
	Cash at Bank	3103		550	
	(Purchased GST-free inventories, bank payment 569151)				
28	M Viviani	3104.1	1 650		
	GST Collected	4102.2		150	
	Sales	1101		1 500	
	(Sold GST-inclusive inventories as per tax invoice 444)				
28	Cost of Goods Sold	2105	1 456		
	Inventories	3106		1 456	
	(Cost of goods sold on tax invoice 444)				

31	Sales Returns and Allowances	1101A	150	
	GST Collected	4102.2	15	
	M Viviani	3104.1		165
	(M Viviani returned GST-inclusive goods as per tax adjustment note 343)			
31	Inventories	3106	130	
	Cost of Goods Sold	2105		130
	(Cost of goods returned on tax adjustment note 343)			

Note that the entry on 22 December did not involve GST. Not all businesses are registered for the GST. But even for those that are, not all inventories that are bought and sold necessarily have a GST element. Care must be taken to include GST only when appropriate.

Remember that references are only entered as posting is carried out.

The completed ledger would appear as follows:

J J Electrical Wholesalers							
Dr				Cr			
Date	Particulars	Ref	Amount \$	Date	Particulars	Ref	Amount \$
2026				2026			
Revenue accounts							
				Sales			
				No 1101			
				Dec 15	Cash at Bank	G6	700
				28	M Viviani	G6	1 500
				Sales Returns and Allowances			
				No 1101A			
Dec 31	M Viviani	G6	150				
Expense accounts							
				Cost of Goods Sold			
				No 2105			
Dec 15	Inventories	G6	400	Dec 31	Inventories	G6	130
28	Inventories	G6	1 456				
Asset accounts							
				Cash at Bank			
				No 3103			
Dec 15	Sales	G6	770	Dec 22	Inventories	G6	550
				M Viviani			
				No 3104.1			
Dec 28	Sales and GST	G6	1 650	Dec 31	Sales Returns and GST	G6	165
				Inventories			
				No 3106			
Dec 1	General Electric	G6	1 700	Dec 3	General Electric	G6	200
22	Cash at Bank	G6	550	15	Cost of Goods Sold	G6	400
31	Cost of Goods Sold	G6	130	28	Cost of Goods Sold	G6	1 456
Liability accounts							
				General Electric			
				No 4101.1			
Dec 3	Inventories and GST	G6	220	Dec 1	Inventories and GST	G6	1 870

GST Collected				No 4102.2			
Dec 31	M Viviani	G6	15	Dec 15	Cash at Bank	G6	70
				28	M Viviani	G6	150
GST Credits Received				No 4102.2A			
Dec 1	General Electric	G6	170	Dec 3	General Electric	G6	20

The trial balance would then appear as follows:

JJ Electrical Wholesalers Trial Balance (extract) as at 31 December 2026			
Account no	Account	Debit \$	Credit \$
1101	Sales		2 200
1101A	Sales Returns and Allowances	150	
2105	Cost of Goods Sold	1 726	
3103	Cash at Bank	220	
3104.1	M Viviani	1 485	
3106	Inventories	324	
4101.1	General Electric		1 650
4102.2	GST Collected		205
4102.2A	GST Credits Received	150	
		<u>\$4 055</u>	<u>\$4 055</u>

Having worked through the illustrative example, some general principles relating to accounting for the GST can now be consolidated.

General principles relating to trading entities recording GST using perpetual inventories

- Cash at Bank, Accounts Receivable and Accounts Payable are always gross amounts and always include any GST. This is the amount we ultimately pay or receive and so it must include GST.
- Revenue and expense accounts are always net of GST and so never have GST included.
- Inventories (and other long-term asset accounts) are always recorded at cost price and never have GST included.
- Cost of Goods Sold is an expense account recording the cost price of any goods that are sold and so never has GST included.
- For purchases and purchases returns of inventories, only one entry is required at cost price.
- For sales and sales returns of inventories, two entries are required: one for the selling price to record the sale; and one for the cost price to record the cost price of the goods sold.
- The GST Collected account (for supplies/sales) and the GST Credits Received account (for acquisitions/purchases) record the amounts of GST relating to any transactions.
- To calculate the net amount of GST to be remitted to the ATO each month, subtract the amount in the GST Credits Received account from the amount in the GST Collected account.

Check for understanding

- 4.44 From the trial balance for JJ Electrical Wholesalers shown on page 134, how much is owing to the ATO for GST?
- 4.45 **Record** the following entries in the general journal of Barnes Tools. **Post** to the ledger using columnar format and **prepare** a trial balance at 30 April.

Apr	3	Purchased goods from Wholesale Ltd for \$1650 including GST, on tax invoice 879.
	11	Received adjustment note 193 from Wholesale Ltd for returns to the value of \$110, GST-inclusive.
	19	Sold goods with a cost price of \$300 for \$500 GST-free, cash register summary.
	20	Purchased goods for \$1914 including GST, using bank payment 572196.
	24	Received bank deposit 729368 for return of \$88 worth of goods purchased on 20 April.
	28	Sold goods with a cost price of \$1000 to Hennings Ltd for \$1980 including GST, on tax invoice 880.
	30	Sent adjustment note 193 for \$176 GST-inclusive to Hennings Ltd for goods returned with a cost price of \$100.

- 4.46 **Record** the following entries in the general journal of Harrison Wholesalers. **Post** to the ledger using T format and **prepare** a trial balance at 30 June.

June	1	J Harrison commenced business with the following assets: cash at bank \$40 000, inventories \$5000, delivery vehicle \$25 000.
	3	Purchased goods from Manufacturers Ltd for \$3000 GST-free, on tax invoice 1079.
	10	Received adjustment note 191 from Manufacturers Ltd for returns to the value of \$220 GST-free.
	14	Paid electricity account for \$165 GST-inclusive, bank payment 172496.
	19	Sold goods with a cost price of \$500 for \$880 GST-free, bank deposit 179471.
	21	Sent adjustment note and bank payment 279164 for \$110 for return of GST-free goods with a cost price of \$70.
	22	Purchased goods \$1100 including GST, bank payment 281965.
	28	Sold goods with a cost price of \$100 to H Jones for \$165 including GST, on tax invoice 140.
	30	Paid Manufacturers Ltd \$1000 on account, using bank payment 362975. Paid wages \$1600, bank payment 795321.

Purchase of assets other than inventories

Businesses purchase many types of assets to enable the business to operate properly. Some, like inventories, are expected to be purchased and sold on a regular basis. Others are purchased with the intention of keeping them in the business for a long period of time, certainly longer than the current accounting period. These long-term assets are generally known as **non-current assets**, and consist mostly of various forms of property, plant and equipment. This is to be compared with **current assets**, which are assets that are very liquid (cash, or easily converted into cash in a short period of time). They include cash at bank, accounts receivables and inventories. These classifications will be discussed further in *Units 3 & 4*.

The following is a transaction typical of this type:

Mar 9 Nugun Industries purchased equipment on credit for \$33 000 (inclusive of GST) from Equipment Suppliers, as shown on tax invoice 5672.

This is a very similar entry to that made for purchases of inventories. Three accounts are affected: Equipment, GST Credits Received, and Equipment Suppliers. The Equipment account is debited with the net purchase price because it is an asset that is increasing. The GST Credits Received account is debited because the business is receiving a tax credit for the acquisition, and so this account is decreasing the liability owed for tax collected. In Nugun's system of accounts, it would be viewed as a negative liability, which is increasing. The Equipment Suppliers account is a liability that is increased by the gross amount. The entry would be:

General Journal				
Date	Particulars	Ref	Dr \$	Cr \$
Mar 9	Equipment (net) GST Credits Received (tax) Equipment Suppliers (gross) (Purchased equipment on credit as per tax invoice 5672)		30 000 3 000	33 000

If the equipment had been purchased for cash, the only change to the above entry would be to credit the Cash at Bank account as a decreasing asset, rather than a credit to Equipment Suppliers. Note that Equipment Suppliers is not a normal Accounts Payable account, but an Other Payable. When posted to the ledger, its reference number would be 4102.3, as it would be the third Other Payable in our chart of accounts. Accounts Payable is generally used only for recording credit purchases of inventories or consumable supplies. This is explained further in Chapter 7 on page 298.

Sale of assets other than inventories

Whenever an asset – such as property, plant and equipment – is disposed of, GST will be payable on the proceeds (except where it is scrapped for no value). At this stage, we are only looking at the case of an asset being sold for its value as recorded in Nugun's books of account (its book value). In *Units 3 & 4*, we will consider the situation whereby an asset is sold for either a profit or a loss.

Consider the following:

Mar 10 Nugun Industries sold furniture on credit to Furniture Traders Ltd for its book value of \$1000. The sale attracted GST, as shown on tax invoice 1002.

The accounts affected are: Furniture Traders Ltd, GST Collected, and Furniture. Furniture Traders Ltd is debited with the gross amount, because it is an asset (an Other Receivable) that is increasing. The GST Collected account is credited to indicate that a liability is increasing for the amount of the GST. The Furniture account is credited with the net sale price, because it is an asset that is decreasing.

The journal entry would be:

General Journal				
Date	Particulars	Ref	Dr \$	P3 Cr \$
Mar 10	Furniture Traders Ltd (gross) GST Collected (tax) Furniture (net) (Sold furniture on credit as per tax invoice 1002)		1 100	100 1 000

Other Receivables is used to record credit sales other than sales of services or inventories, so the account reference number for Furniture Trader Ltd would be 3105.1. If the furniture had been sold for cash, the only change to the above entry would be to have debited Cash at Bank, as the asset increasing, instead of Furniture Traders Ltd.

Drawings of cash

An owner may withdraw cash, inventories and other assets from the business for **personal use**. Each time drawings of such assets are made from the business, the owner's equity is decreased. Such drawings are recorded in a Drawings account. Because Drawings has the effect of decreasing owner's equity, this is a negative owner's equity account, and thus has a debit nature (the opposite of owner's equity). Its chart of account number would be 5101A. As this is neither a supply nor an acquisition, there is no GST involved.

Consider the following transaction:

Mar 11 V Nugun, the owner of Nugun Industries, withdrew \$200 for personal use, bank payment 174775.

Two accounts are affected by this transaction: Drawings and Cash at Bank. Drawings is a negative owner's equity item, with a debit nature. It is being increased, so it is debited with the \$200. Cash at Bank is an asset account with a debit nature. It is being decreased as cash is withdrawn. Therefore, it is credited.

The entry would be:

General Journal				
Date	Particulars	Ref	Dr \$	P3 Cr \$
Mar 11	Drawings Cash at Bank (Owner withdrew cash for personal use, bank payment 174775)		200	200

Drawings of inventories

If inventories are withdrawn for personal use, an adjustment to GST is required if the inventories are ones for which an input tax credit has already been received.

Examine the following transaction:

Mar 12 The owner of Nugun Industries withdrew GST-inclusive inventories worth \$132 for personal use on journal voucher 221.

In this case, the business owner is the final consumer of the goods, so the drawings taken for personal use must include the GST. The Drawings account is debited because it is a negative owner's equity item being increased. As with other final consumers, the amount involved would be the gross amount including GST (\$132). A tax credit would have been received and entered in the GST Credits Received account when these goods were purchased. Because the goods are not being sold, the tax credit has to be reversed. The GST Credits Received account is credited with \$12 because this negative liability is decreasing. The Inventories account shows those inventories that have been purchased for resale. Although these inventories are not being sold, they are being withdrawn from the business, and the asset is being decreased. Thus the Inventories account must be credited with the amount of the original net cost.

The general journal entry would be:

General Journal				
Date	Particulars	Ref	Dr \$	P3 Cr \$
Mar 12	Drawings (gross) GST Credits Received (tax) Inventories (net) (Owner withdrew inventories for personal use as per journal voucher 221)		132	12 120

By now, you should have noticed a pattern of similarity for dealing with the amounts for entries involving GST:

- Any businesses or people involved in the transaction are affected by the gross amount, and any effect on cash will be at the gross amount, including GST. This means accounts receivable and payable are affected by the gross amount; owner's accounts (such as Drawings) are affected by the gross amount; and the Cash at Bank account is affected by the gross amount of the transaction.
- Any asset, expense or revenue account on which GST is charged is recorded at the net amount. This means that the Inventories account, Property, Plant and Equipment accounts, expense accounts (such as Electricity or Telephone), and revenue accounts (such as Sales or Service Fees) are affected by the net amount of the transaction.
- The appropriate GST account is affected only by the amount of tax involved, which will be one-tenth of the net amount or one-eleventh of the gross amount. This means that GST Collected and GST Credits Received will always be affected only by the amount of GST involved in the transaction.

Correction of errors

Occasionally, errors may be made in the records. In business, it is preferable that any errors be adjusted through the general journal. Entries should not simply be crossed out, erased or changed once they have been recorded.

As discussed previously, to arrive at the appropriate error adjustment entry, always examine the particular situation and decide which accounts must be increased and decreased and by what amount. Consider this example:

Mar 10 Nugun had erroneously entered the sale of furniture to the Sales account for \$1000 instead of the Furniture account. The error was discovered when the accounts were balanced at 31 March.

The entries to Furniture Traders and to GST are correct. The correction entry should therefore show a decrease to the asset Furniture. This means the Furniture account must now be credited because it is an asset account that is decreasing. The Sales account should be debited because this account had erroneously been credited, and this wrong entry must be offset. Sales are decreased.

The entry would show:

General Journal					P3
Date	Particulars	Ref	Dr \$	Cr \$	
Mar 31	Sales Furniture (Correction of error in entry made on 10 March)		1000	1000	

Check for understanding

4.47 Complete the following analysis table for a number of business transactions that have occurred during the month:

Date	Transaction	Accounts involved	Type of account	Nature of account	Inc/Dec	Dr/ Cr	Amount \$
May 3	Purchased motor vehicle for \$22 000 cash (GST-inclusive)	Motor Vehicles GST Credits Received	A -L A	Dr Dr	↑ ↓	Dr	20 000
9	Owner withdrew \$500 for personal use	Cash at Bank	-OE	Dr	↓	Cr	
23	Owner withdrew GST-inclusive inventories worth \$77 for personal use						77 7 70

4.48 Prepare general journal entries for the following Deeb Trading transactions.

Aug	5	Purchased furniture from J Richards for \$4400 GST-inclusive, tax invoice 589.
	15	Owner withdrew GST-inclusive inventories worth \$220 for personal use, inter-office memorandum 247.
	31	Owner withdrew cash of \$600 for personal use, bank payment 782114.

4.49 T Curuso runs a service station called Ennis Fuels that also sells small amounts of food and general merchandise. From the following information, **prepare** general journal entries, **post** these to the ledger in T format and **prepare** a trial balance as at 30 June.

June	1	Owner commenced business with land \$300 000, building \$50 000, furniture \$15 000 and cash at bank \$2000.
	4	Purchased inventories for \$3300 (GST-inclusive) from Motoroil Ltd, tax invoice 108.
	6	Sold inventories with a cost price of \$2500 for \$4466 cash (GST-inclusive), tax invoices/cash summary.
	9	Paid wages \$750, bank payment 329646. Performed mechanical services for \$550 cash (GST-inclusive), tax invoice and bank deposit 472666.
	11	Purchased GST-free inventories for \$770 from Freshfood Ltd, tax invoice 446.
	13	Returned inventories worth \$200 to Freshfood Ltd, adjustment note 45.
	14	Sold GST-free inventories for \$675 cash (cost price \$400), tax invoices/cash summary.
	20	Purchased equipment for \$8800 cash (GST-inclusive), bank payment 416792.
	23	Paid Motoroil Ltd \$2000 on account, bank payment 493264.
	24	Paid telephone \$550, bank payment 507261. Paid stationery \$77, bank payment 619562.
	26	Paid advertising \$198 (GST-inclusive), bank payment 719247.
	28	Sold GST-free inventories to J Jones \$220 (cost price \$140), tax invoice 111.
	30	Paid interest on overdraft \$110, bank statement. Paid wages \$750, bank payment 726443. Owner withdrew \$330 GST-inclusive inventories for personal use, as per journal voucher 001.

Illustrative example

Remember that not all goods and services attract GST. This means that when analysing transactions it is necessary to know which ones will have GST added or included and which ones will not. As you also saw earlier, entities can claim input tax credits for some goods and services they are supplying, but not for others.

On the following page is a list of transactions for Brown's Foods, a food retailer and caterer, supplying both taxable supplies and GST-free supplies. This means the business has to add GST to sales of its taxable supplies (such as hot cooked food sold and catering services performed), but not to sales of its GST-free

supplies (such as basic food items). It can claim input tax credits for any purchases and expenses to which GST has been added (such as purchases of processed food, furniture, commercial rent and insurance). You should remember that wages and salaries and bank charges do not attract GST.

June 1	G Brown commenced business with a deposit to Brown's Foods bank account of \$25 000, bank deposit 101647.
7	Performed services for \$440 cash (GST-inclusive), tax invoice/cash docket 0706001.
8	Paid rent \$770, bank payment 269416. Purchased GST-free inventories for \$121, bank payment 274442.
9	Purchased equipment for \$726 (GST-inclusive) from Hardware Ltd, tax invoice 389.
11	Purchased inventories for \$264 (GST-inclusive) from T Thompson, tax invoice 836.
12	Returned inventories valued at \$55 (GST-inclusive) to T Thompson, adjustment note 056.
16	Paid wages \$320, bank payment 301647.
23	Sold GST-inclusive inventories with cost price of \$150 for \$220 to R Russo, tax invoice 752.
25	Received \$220 from R Russo, bank deposit 269174.
26	Paid electricity \$209, bank payment 417926.
28	Sold inventories with cost price of \$50 for \$99 (GST-free) to R Russo, tax invoice 753.
29	Sent adjustment note 201 for \$44 to R Russo, who returned GST-free goods with a cost price of \$30.
30	Owner withdrew \$400 cash for personal use, bank payment 517624. Paid bank charges \$33, as per bank statement.

The completed journal would appear as follows:

Brown's Foods General Journal					P1
Date	Particulars	Ref	Dr \$	Cr \$	
June 1	Cash at Bank Capital – G Brown (Commenced business, bank deposit 101647)	3103 5101	25 000		25 000
7	Cash at Bank GST Collected Service Fees Revenue (Performed services for cash, tax invoice 0706001)	3103 4102.2 1102	440		40 400
8	Rent Expense GST Credits Received Cash at Bank (Paid rent, bank payment 269416)	2414 4102.2A 3103	700 70		770
8	Inventories Cash at Bank (Purchased GST-free goods, bank payment 274442)	3106 3103	121		121

Date	Particulars	Ref	Dr \$	Cr \$
9	Equipment GST Credits Received Hardware Ltd (Purchased equipment, tax invoice 389)	3304 4102.2A 4102.3	660 66	726
11	Inventories GST Credits Received T Thompson (Purchased inventories, tax invoice 836)	3106 4102.2A 4101.1	240 24	264
12	T Thompson GST Credits Received Inventories (Returned inventories, adjustment note 056)	4101.1 4102.2A 3106	55	5 50
16	Wages and Salaries Cash at Bank (Paid wages, bank payment 301647)	2421 3103	320	320
23	R Russo GST Collected Sales (Sold inventories, tax invoice 752)	3104.1 4102.2 1101	220	20 200
23	Cost of Goods Sold Inventories (Cost of goods sold, tax invoice 752)	2105 3106	150	150
25	Cash at Bank R Russo (Received payment, bank deposit 269174)	3103 3104.1	220	220
26	Electricity GST Credits Received Cash at Bank (Paid electricity, bank payment 417926)	2407 4102.2A 3103	190 19	209
28	R Russo Sales (Sold inventories, tax invoice 753)	3104.1 1101	99	99
28	Cost of Goods Sold Inventories (Cost of goods sold on tax invoice 753)	2105 3106	50	50
29	Sales Returns and Allowances R Russo (Inventories returned, adjustment note 201)	1101A 3104.1	44	44
29	Inventories Cost of Goods Sold (Cost of goods returned on adjustment note 201)	3106 2105	30	30
30	Drawings Cash at Bank (Owner's drawings, bank payment 517624)	5101A 3103	400	400
30	Bank Charges Cash at Bank (Paid bank charges as per bank statement)	2502 3103	33	33

The ledger postings from these entries appear below:

Brown's Foods Ledger					
Date	Particulars	Ref	Dr \$	Cr \$	Balance \$
Revenue accounts					
Sales					No 1101
June 23	R Russo	G1		200	200 Cr
28	R Russo	G1		99	299 Cr
Sales Returns and Allowances					No 1101A
June 29	R Russo	G1	44		44 Dr
Service Fees Revenue					No 1102
June 7	Cash at Bank	G1		400	400 Cr
Expense accounts					
Cost of Goods Sold					No 2105
June 23	Inventories	G1	150		150 Dr
28	Inventories	G1	50		200 Dr
29	Inventories	G1		30	170 Dr
Electricity					No 2407
June 26	Cash at Bank	G1	190		190 Dr
Rent Expense					No 2414
June 8	Cash at Bank	G1	700		700 Dr
Wages and Salaries					No 2421
June 16	Cash at Bank	G1	320		320 Dr
Bank Charges					No 2502
June 30	Cash at Bank	G1	33		33 Dr
Asset accounts					
Cash at Bank					No 3103
June 1	Capital – G Brown	G1	25 000		25 000 Dr
7	Service Fees and GST	G1	440		25 440 Dr
8	Rent and GST	G1		770	24 670 Dr
8	Inventories	G1		121	24 549 Dr
16	Wages and Salaries	G1		320	24 229 Dr
25	R Russo	G1	220		24 449 Dr
26	Electricity and GST	G1		209	24 240 Dr
30	Drawings	G1		400	23 840 Dr
30	Bank Charges	G1		33	23 807 Dr

R Russo					No 3104.1
June 23	Sales and GST	G1	220		220 Dr
25	Cash at Bank	G1		220	0 Dr
28	Sales	G1	99		99 Dr
29	Sales Returns	G1		44	55 Dr
Inventories					No 3106
June 8	Cash at Bank	G1	121		121 Dr
11	T Thompson	G1	240		361 Dr
12	T Thompson	G1		50	311 Dr
23	Cost of Goods Sold	G1		150	161 Dr
28	Cost of Goods Sold	G1		50	111 Dr
29	Cost of Goods Sold	G1	30		141 Dr
Equipment					No 3304
June 9	Hardware Ltd	G1	660		660 Dr
Liability accounts					
T Thomson					No 4101.1
June 11	Inventories and GST	G1		264	264 Cr
12	Inventories and GST	G1	55		209 Cr
GST Collected					No 4102.2
June 7	Cash at Bank	G1		40	40 Cr
28	M Viviani	G1		20	60 Cr
GST Credits Received					No 4102.2A
June 8	Cash at Bank	G1	70		70 Dr
9	Hardware Ltd	G1	66		136 Dr
11	T Thompson	G1	24		160 Dr
12	T Thompson	G1		5	155 Dr
26	Cash at Bank	G1	19		174 Dr
Hardware Ltd					No 4102.3
June 9	Equipment and GST			726	726 Cr
Owner's Equity accounts					
Capital – G Brown					No 5101
June 1	Cash at Bank	G1		25 000	25 000 Cr
Drawings					No 5101A
June 30	Cash at Bank	G1	400		400 Dr

The trial balance would appear as follows:

Brown's Foods			
Trial Balance as at 30 June			
Account no	Account	Debit \$	Credit \$
1101	Sales		299
1101A	Sales Returns and Allowances	44	
1102	Service Fees Revenue		400
2105	Cost of Goods Sold	170	
2407	Electricity	190	
2414	Rent Expense	700	
2421	Wages and Salaries	320	
2502	Bank Charges	33	
3103	Cash at Bank	23 807	
3104.1	R Russo	55	
3106	Inventories	141	
3304	Equipment	660	
4101.1	T Thompson		209
4102.2	GST Collected		60
4102.2A	GST Credits Received	174	
4102.3	Hardware Ltd		726
5101	Capital – G Brown		25 000
5101A	Drawings	400	
		<u>\$26 694</u>	<u>\$26 694</u>

This example shows some of the many possibilities for the various categories of goods and services and other transactions that might occur. Some of the sales were taxable, while others were GST-free. Some of the purchases and expenses included GST and so would support a claim for an input tax credit, but others were GST-free or input taxed and so no part of the payment for these could be claimed back.

Check for understanding

4.50 From the figures in the trial balance for Brown's Foods shown on this page, would the entity have to pay GST or receive a refund? **Explain** why this situation might arise with a commencing business.

4.51 From the following information for the business of Ma Sales, retailer, **prepare** general journal entries, **post** these to a T format ledger and **prepare** a trial balance as at 30 September.

Sept	1	A Ma commenced business with assets of furniture \$5000 and cash at bank of \$30 000.
	4	Paid rent \$2090, cheque 001.
	10	Purchased GST-free inventories for \$1200 from Wholesale Food Ltd, tax invoice 247. Cash sales of GST-free goods with a cost price of \$500 for \$850, cash register summary.
	13	Sold furniture for \$5500 (GST-inclusive) to Furniture Seconds Ltd, tax invoice 301.
	15	Purchased inventories for \$5280 (GST-inclusive) from Wholesale Food Ltd, tax invoice 255.
	17	Returned inventories valued at \$550 (GST-inclusive) to Wholesale Food Ltd, adjustment note 75.
	18	Paid wages \$1330, cheque 002.
	19	Cash sales of goods with cost price of \$2000 for \$3300 GST-free, cash register summary.
	21	Sold GST-inclusive inventories with cost price of \$500 for \$880 to N Nash, tax invoice 302.
	26	Received \$880 from N Nash, receipt 801.
	27	Purchased advertising from Mail Newspapers \$418, tax invoice 993.
	28	Sold inventories with cost price of \$300 for \$594 (GST-inclusive) to P Peters, tax invoice 303.
	29	Sent adjustment note 501 for \$176 to P Peters, who returned taxable goods with a cost price of \$100.
	30	Owner withdrew \$500 cash for personal use, cheque 003.

4.52 From the following information for the business of Garronne Distributors, **prepare** general journal entries, **post** these to a columnar format ledger and **prepare** a trial balance as at 31 May.

May	1	B Garronne commenced business with a deposit to the business's bank account of \$25 000, bank deposit 100296.
	8	Paid rent \$550, bank payment 109277.
		Purchased GST-free inventories for \$1210, bank payment 207926.
	14	Performed services for \$880 cash (GST-inclusive), bank deposit 209766.
	16	Purchased furniture for \$1452 (GST-inclusive) from Harvey Jones Ltd, tax invoice 388.
	17	Purchased inventories for \$528 (GST-inclusive) from T Terry, tax invoice 556.
	20	Returned inventories valued at \$55 (GST-inclusive) to T Terry, adjustment note 775.
	21	Paid advertising \$330, bank payment 306444.
	22	Cash sales of goods with cost price of \$200 for \$330 GST-free, cash register summary.
		Sold GST-inclusive inventories with cost price of \$300 for \$440 to N Brown, tax invoice 763.
	24	Received \$440 from N Brown, bank deposit 403771.
	29	Paid wages \$1209, bank payment 597111.
	30	Sold inventories with cost price of \$100 for \$198 (GST-inclusive) to P Donald, tax invoice 764.
		Sent adjustment note 111 for \$88 to P Donald, who returned taxable goods with a cost price of \$60.
	31	Owner withdrew GST-inclusive inventories for personal use, \$440, inter-office memorandum 05.
		Paid bank charges \$20, as per bank statement.

4.53 The illustrative example on page 103 shows how a business records many transactions without GST. These would be businesses operating to make a profit that are not registered for GST as they anticipate they will not have an annual turnover of more than \$75 000. If they buy something, the total cost of the product or service (including GST) is the amount entered into the records as an expense or asset. No record is kept of the GST. Likewise, when they sell a service or a product, they do not have to add GST so the selling price is not increased by 10 per cent.

On the other hand, the illustrative example on page 140 shows how businesses that are registered for the GST must account for it. The business must keep track of the amounts of GST being processed.

Using these two illustrative examples, **synthesise** the main similarities and differences in the recording process between a business that is registered for GST and one that is not.

CHAPTER REVISION

4.54 Multiple choice

Complete the following multiple-choice questions by choosing the best answer.

- 1 The accounting process is typically:
 - A journal, ledger, trial balance
 - B source document, journal, trial balance
 - C source document, journal, ledger
 - D journal, trial balance, ledger.
- 2 If an accounts receivable is paid by direct deposit, the source document is the:
 - A bank statement
 - B cheque
 - C cash register summary
 - D invoice.
- 3 Which of the following does not produce a source document?
 - A generating a receipt
 - B finalising an invoice
 - C discussing on the phone the price of inventories
 - D completing a journal voucher
- 4 Making a payment by electronic funds transfer ultimately results in:
 - A a credit to the Cash at Bank account
 - B a debit to a revenue account
 - C an invoice produced as a source document
 - D no entry in the records.
- 5 When the owner withdraws cash, the following general journal entry is made:
 - A Capital Dr Supplies Cr
 - B Capital Dr Cash at Bank Cr
 - C Drawings Dr Supplies Cr
 - D Drawings Dr Cash at Bank Cr
- 6 The following entry was recorded:
Advertising Dr \$500
Preston Advertising Pty Ltd Cr \$500
Which of the following statements is correct about the entry?
 - A Paid for advertising \$500.
 - B Bought advertising on credit \$500.
 - C Received \$500 for advertising.
 - D Preston Advertising Pty Ltd owes the business \$500.
- 7 The Cost of Goods Sold account is:
 - A an asset
 - B a liability
 - C a revenue
 - D an expense.
- 8 The GST Credits Received account is debited because it is:
 - A an expense that is decreasing
 - B a negative liability that is increasing
 - C a revenue that is increasing
 - D an asset that is decreasing.
- 9 If credit purchases are returned, the Inventories account is credited because it is:
 - A an expense that is decreasing
 - B a liability that is increasing
 - C a revenue that is increasing
 - D an asset that is decreasing.
- 10 Mostert Industries sent an adjustment note to N Nay for sales returns of \$330, including GST. Nay will be credited with this amount. Which of the following statements is correct to record the debit side of the entry relating to the selling price element of this transaction?
 - A Sales Returns and Allowances \$300, and GST Credit Received \$30
 - B Sales Returns and Allowances \$330
 - C Sales Returns and Allowances \$300, and GST Collected \$30
 - D Sales Returns and Allowances \$300, and Cost of Goods Sold \$30
- 11 Leonardi Systems sold a vehicle that cost \$16 000 to K Slater for \$16 000. Leonardi made an entry in the general journal as if this was a sale of inventories for \$16 000. It should have been recorded as the sale of a long-term asset.

- An entry is now recorded in the general journal to correct the error. Which of the following statements is correct?
- A** K Slater will be debited for \$16 000 and Motor Vehicle will be credited for \$16 000.
- B** Sales will be debited for \$16 000 and K Slater will be credited for \$16 000.
- C** K Slater will be debited for \$16 000 and Sales will be credited for \$16 000.
- D** Sales will be debited for \$16 000 and Motor Vehicle will be credited for \$16 000.
- 12** Which of the following is subject to GST in Australia?
- A** milk
- B** computers
- C** international postage
- D** residential rent
- 13** If a business wanted to receive \$5500 exclusive of GST for some goods, how much would the GST be?
- A** \$550
- B** \$500
- C** \$55
- D** none of the above
- 14** Which of the following would result in a debit entry to the Inventories account for \$1900?
- A** Selling inventories for \$2090 (inclusive of GST).
- B** Buying inventories for \$1900 (GST free).
- C** Buying inventories for \$2090 (GST free).
- D** Buying inventories for \$1900 (inclusive of GST).
- 15** Mandersen Pty Ltd purchased for cash a machine worth \$7480 (including GST). Which of the following is correct?
- A** The Cash at Bank account would be Debit for \$7480.
- B** The Machinery account would be Debit for \$6800.
- C** The Cash at Bank account would be Credit for \$6800.
- D** The Machinery account would be Debit for \$7480.
- 16** Tham Trading sold goods worth \$2000 to V Young on credit for \$3300 (including GST). Which of the following is correct?
- A** The Inventories account would be Debit for \$2000.
- B** The Cost of Goods Sold account would be Debit for \$3300.
- C** The V Young account would be Debit for \$3300.
- D** The amount of the GST for the transaction is \$330.

Using the ledger account below, answer questions 17–20.

Cash at Bank				No 3103					
Apr	1	Capital	GJ1	100 000	Apr	1	Motor Vehicle	GJ1	20 000
	20	Service Fees Revenue	GJ1	4 000		1	Equipment	GJ1	10 000
	22	Service Fees Revenue	GJ1	7 000		1	Furniture	GJ1	4 000
						2	Rent Expense	GJ1	8 000
						3	Advertising	GJ1	300
						3	Office Expenses	GJ1	200
						4	Cash Investment	GJ1	20 000
						14	Wages	GJ1	1 600
						28	Wages	GJ1	1 600
						29	Drawings	GJ1	3 000
						30	Bank Charges	GJ1	10

- 17 Which of the following is correct?
- A The owner introduced as capital a motor vehicle, equipment and furniture.
 - B Service fees revenue for the month totalled \$7000.
 - C The business received \$8000 in rent.
 - D None of the above.
- 18 Which of the following is correct?
- A The business received an extra \$20 000 in capital on 4 April.
 - B The owner introduced an extra \$20 000 in capital on 4 April.
 - C The business sold some equipment for cash on 1 April.
 - D The source document for the transaction on April 30 is the bank statement.
- 19 In regard to the total amount of Service Fees Revenue for the month of April:
- A \$11 000 was received in cash, but some accounts payable could increase it above \$11 000.
 - B \$11 000 was received in cash, but some accounts payable could decrease it below \$11 000.
 - C \$11 000 was received in cash, but some accounts receivable could increase it above \$11 000.
 - D None of the above.
- 20 The balance of the account is:
- A \$68 710 Dr
 - B \$42 290 Dr
 - C \$42 290 Cr
 - D none of the above.

4.55 Case study

Synthesise the information provided in Stimulus 1 and 2. **Open** the ledger accounts with balances, **prepare** general journal entries for the transactions for the month, **post** these to a T format ledger and take out a trial balance.

STIMULUS 1

The ledger of Pale Industries owned by M Pale showed the following balances at 1 April:

	\$	\$
Cash in Hand		100
Cash at Bank		400
Accounts Receivable		
T Blake	50	
L Gibson	<u>110</u>	160
Inventories		900
Vehicle		3 000
Equipment		5 000
Buildings		101 000
Land		201 000
Accounts Payable		
Racey & Co	500	
Kyanga Trading	<u>100</u>	600
Loan from Bank (short term)		2 000
Capital		308 960

STIMULUS 2 – DOCUMENTS

Pale Industries Cash Register Summary	
2 Apr 2026	\$220*
*GST of \$20	

Cost price of goods \$150

Racey & Co Tax Invoice	
2 Apr 2026	No 101
Sold To: Pale Industries	
	\$330*
*GST included	

XYZ Bank Electronic Payment	
Payer name: Pale Industries	
Amount: \$500	
Payment Date: 2 Apr 2026	
Description: Loan from Bank	
Payment No: 100061	

Pale Industries Cash Register Summary	
3 Apr 2026	\$110*
*GST of \$10	

Cost price of goods \$70

Office Memorandum No 5	
Date 3 Apr 2026	
Particulars Drawings of goods \$44*	
*GST included	

XYZ Bank Bank Statement (Extract)		
Date	Particulars	Credit
Apr 4	Deposit Mann Cars	3 300

Amount included GST re sale of car

Kyanga Trading Tax Invoice	
4 Apr 2026	No 202
Sold To: Pale Industries	
	\$200

Pale Industries Cash Register Summary	
4 Apr 2026	\$150

Cost price of goods \$90

XYZ Bank Bank Statement (Extract)		
Date	Particulars	Credit
Apr 5	Deposit T Blake	50

XYZ Bank Electronic Payment	
Payer name: Pale Industries	
Amount: \$500	
Payment Date: 6 Apr 2026	
Description: Racey & Co	
Payment No: 204736	

Pale Industries Tax Invoice	
No 059	6 Apr 2026
To: L Gibson	
	\$110*
*GST included	

Cost price of goods \$60

Kyanga Trading Tax Invoice	
7 Apr 2026	No 707
Sold To: Pale Industries	
	\$110*
*GST of \$8	

Kyanga Trading Adjustment Note	
No 51	8 Apr 2026
To: Pale Industries	
	\$55*
*GST included	

Pale Industries Cash Register Summary	
10 Apr 2026	\$1100*
*GST of \$100	

Cost price of goods \$700

XYZ Bank Bank Statement (Extract)		
Date	Particulars	Debit
Apr 4	Interest on Loan	50

Kyanga Trading	
Adjustment Note	
No 52	17 Apr 2026
To: Pale Industries	
	\$5

Pale Industries	
Adjustment Note	
No 97	19 Apr 2026
To: L Gibson	
	\$11*
* GST included	

Cost price of goods \$6

Pale Industries	
Cash Register Summary	
20 Apr 2026	\$80

Cost price of goods \$40

XYZ Bank		
Bank Statement (Extract)		
Date	Particulars	Credit
Apr 20	Deposit L Gibson	100

XYZ Bank		
Bank Statement (Extract)		
Date	Particulars	Credit
Apr 23	Deposit ABC Finance	\$33 000

(Long term loan)

Chan Developments	
Tax Invoice	
23 Apr 2026	No 925
Sold To: Pale Industries	
Particulars: Commercial Land	
	\$33 000*
*GST included	

XYZ Bank	
Electronic Payment	
Payer name: Pale industries	
Amount: \$33 000	
Payment Date: 26 Apr 2026	
Description: Chan Developments	
Payment No: 306723	

Pale Industries	
Tax Invoice	
No 060	26 Apr 2026
To: T Blake	
	\$66*
*GST included	

Cost price of goods \$40

Office Memorandum No 6	
Date	26 Apr 2026
To	Gordon Kyron
Particulars	Received a phone call from Kim Millisant from Millisant Trading about a possible sale of GST-inclusive goods worth \$4620. Please follow up.

Granger Medical	
Tax Invoice	
27 Apr 2026	No 853
Sold To: Pale Industries	
Goods	\$100
Received via debit card	\$100

Par Stationery	
Tax Invoice	
28 Apr 2026	No 316
Sold To: Pale Industries	
Particulars	\$
Stationery	110*
*GST included	
Received via debit card	\$110

Office Memorandum No 7	
Date	30 Apr 2026
Particulars	Transaction on 27 April incorrectly processed. This was personal expenditure so treat as Drawings.

5

ACCOUNTING TECHNOLOGY

LEARNING OBJECTIVES

At the end of this chapter you should be able to:

- explain the components of a computer system
- explain the major features of accounting packages
- synthesise using computer accounting processes to set up and record general journal entries and generate appropriate reports
- explain the relationship between subsidiary ledgers and the general ledger
- explain, illustrate and interpret the posting to a ledger system incorporating subsidiary ledgers for accounts receivable and accounts payable
- describe the items classified under the term 'inventories'
- describe various inventory costing methods
- explain the perpetual inventory system
- explain, illustrate and interpret accounting for inventories using the perpetual inventory system and an inventory subsidiary ledger
- using an accounting package, enter GST transactions through appropriate menu options, and post to a ledger system incorporating subsidiary ledgers for accounts receivable, accounts payable and inventories
- explain the reports available from an accounting package
- explain the main features of spreadsheets (including business graphics)
- synthesise spreadsheet features and functions to various accounting applications.

*Accounting technology***A computer system**

- Hardware
- Software
- People
- Benefits

Accounting software**Accounting packages**

- Features of accounting packages
- Real-world accounting systems

**An introduction to MYOB AccountRight:
general journal entries**

- Setting up
- Entering transactions
- Reports

**Accounting packages: control accounts and
subsidiary ledgers**

- Accounting for control accounts and subsidiary ledgers for accounts receivable and accounts payable

Accounting packages: inventories

- Perpetual inventory system
- Inventory costing methods
- Accounting records under the perpetual inventory system using an inventory subsidiary ledger

MYOB AccountRight accounting package for a trading business with GST using subsidiary ledgers

- Setting up
- Entering transactions through the menu options
- Inventories command centre
- Reports

Spreadsheets

- Features of spreadsheets

Business graphics in spreadsheets

Chapter revision

Weblinks:

- Cloud computing (p.155)

 Nelson MindTap

To access resources above, visit
cengage.com.au/nelsonmindtap



A computer system

A computer system comprises the hardware, software and personnel involved in providing the computing capability of an organisation.

A computer system is thus made up of three components:

- hardware
- software
- people.

Hardware

Hardware is the physical equipment used in the system. This includes:

- input devices such as a keyboard; mouse or touchpad; touch screens (including digital keyboard); light pen; optical character recognition (OCR) as used by the post office to read handwritten postcodes on letters; optical mark recognition (OMR) as used in Lotto; barcodes and point-of-sale (POS) devices as used in supermarkets; touch phones for entering credit card details for payment of bills; automated teller machines (ATMs) to obtain money; scanners to scan images and editable text via OCR; chip and magnetic card reader as used with debit and credit cards at retail stores; webcam (cameras connected to the Internet); speech recognition via a microphone (e.g. Siri on iPhones); biometric identification scanners (using fingerprints, hand, face, eyes and voice); and virtual reality goggles and gloves
- the computer, which consists of a central processing unit (CPU) and internal storage (memory). These now take many forms, including huge computers for banks, supermarkets and insurance companies down to personal computers (PCs), laptops, notebooks, ultrabooks and smartphones

- secondary storage devices such as magnetic hard disk drives (internal and external), solid state drive (SSD), universal serial bus (USB) flash drives and optical disk drives (CD-ROMs or CDs and DVDs). A common and versatile form of storage is ‘in the cloud’, where various providers allow users to store data and access that data from any digital source
- communication devices such as network interface cards, modems, Wi-Fi dongle/USB stick; and routers (to connect to other computers and/or access the Internet)
- output devices such as monitors, printers (ink jet, laser and 3D), plotters, POS devices, ATMs, multimedia and speakers.

These devices form the basic hardware components of a computer system as shown in Figure 5.1.

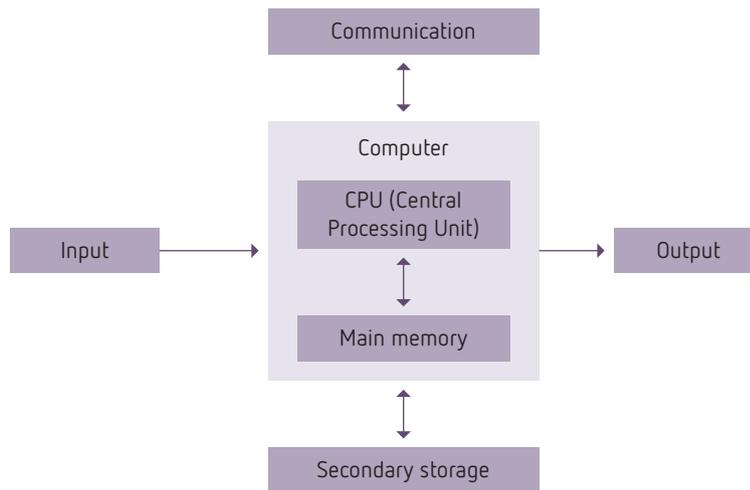


Figure 5.1 Hardware components of a computer system

Real-world application



Cloud computing

Most businesses want to expand, and one of the dilemmas they have when they set up is providing for that expansion. Follow the weblink to watch a video on cloud computing.

The advantages of using cloud computing are explained. However, research some of the disadvantages or the pitfalls that businesses need to be aware of when storing their data ‘in the cloud’. Form small groups and compare your answers.



Weblink
Cloud
computing

Software

Software is the set of computer programs (the instructions for the various processing operations) that makes the hardware function. It is important to remember that the hardware is of no use unless controlled by a software program. There are three types of software:

- **system software**, which is the ‘behind the scenes’ set of programs that control the computer system. This is often referred to as the operating system. Examples include Windows, Apple OS and iOS, Chrome OS and Unix
- **development software**, which is a set of step-by-step instructions that guide the computer to complete a task. This type of software is commonly referred to as a programming language. Some of the more common languages are C, Java, SQL, JavaScript, R, C++ (C plus plus) and C# (C sharp)

- **application software**, which performs such tasks as keeping records, word processing, using spreadsheets, accessing the Internet, and so on. Some of the more common examples of application software include MYOB, Reckon/Quickbooks, Xero, MS Word, MS Excel, MS Edge, Apple Safari, Google Chrome and Mozilla Firefox. As well, mobile applications for mobile devices such as phones and tablets (commonly referred to as apps) are exploding in use. Application software can be specifically written for a particular business (in-house software) or can be purchased from a supplier or downloaded from an electronic store.

People

Various people operate the hardware, produce the software, or administer and use the system. Such personnel include systems analysts, programmers, operators, technicians, data entry clerks and end users.

Benefits

A computerised system has many benefits. These include speed, accuracy, the ability to process data automatically, flexibility and compact business records.

- The **operating speed** of a computer is generally measured in gigahertz (billion cycles per second) or MIPS (millions of instructions per second).
- Computers perform arithmetic and other functions through the use of electrical currents moving through complex electrical circuits. Each of these circuits has been thoroughly tested before installation so that results will be predictable and **accurate**. If programmed correctly, computers almost never make a mistake. Unlike human beings, computers do not suffer from boredom, fatigue or emotional problems, which can cause errors. Electrical failures and computer malfunctions do occur, but not often. Most computer output errors occur because of human error in programming or incorrect input of the raw data.
- A computer requires minimal human effort. Processing is more **automatic** because of the computer's ability to follow a series of instructions stored in its memory. It will carry these out in the exact sequence required and with a minimum of human intervention. Many people are still needed, however, to collect and prepare the data that the computer processes and to operate the computer.
- Computers add more **flexibility** to the solution of business problems. A different program can be written for each new problem encountered. Provided that sufficient capacity has been built into the computer, and that programmers can devise a means of solving the problem, any business data processing problem can be solved.
- The use of computers also results in very **compact business records**. A large volume of paper is replaced by magnetic and optical media that store the data in a small space. This is particularly the case with Acrobat PDFs (Portable Document Files) that can electronically store documents and correspondence. Consider the savings for banks, insurance companies, magazine and newspaper publishers, and firms with large numbers of customers.

Although some computers require special air-conditioned, dust-free rooms in which to operate, the amount of space required is generally not large. The trend is towards even further miniaturisation of all components and storage media in computer systems, so space savings will increase still further in the future.

These benefits enable businesses to run 'paperless offices'. If all transactions and correspondence can be stored electronically, then there is no need for paper and hence a saving in administrative costs.

Interesting accounting fact

Did you know?

Accounting technology has been around longer than the profession of accounting itself

Many centuries ago, the abacus was the first ‘calculator’. The abacus is so technologically advanced that many people still use it for everyday transactions.

Leonardo da Vinci sketched a prototype of a computational machine that used 13 wheels to register numerical digits. Commercial adding machines were first produced in the 1800s. It wasn’t until the 1940s that the first computing machines were introduced for businesses to use, and they took up an entire room, although their computing power was minuscule compared to what is available today on your smartphone!

Source: Adapted from Accounting and Technology – Fun Facts, Kashoo: <https://kashoo.com/blog/accounting-and-technology-fun-facts/>

Check for understanding

- 5.1
 - a **Identify** the main components of a computer system.
 - b **Explain** the term ‘computer hardware’.
- 5.2
 - a **Explain** the term ‘software’ and the three types of software.
 - b **Describe** three operating systems and identify which brands use each operating system.
 - c Name various categories of application software and some brand names that are applicable to those categories.
- 5.3 Find out what operating system is available on the computer you use.
- 5.4 How are people involved in a computer system?
- 5.5 **Describe** the benefits of a computer system. How has this led to the ‘paperless office’?

Real-world application



Business ethics

You work for a large accounting firm with hundreds of clients. A cousin has recently started her own business selling computer consumables. Her business at this stage is quite small and will compete with a number of established firms selling similar products. One, a large multinational, is a client of yours. You have access to the company’s list of clients and its pricing policies. You know these would be very helpful to your cousin.

Discuss whether you should make this material available to your cousin.

Accounting software

There are two main types of application software that are used in accounting – accounting packages and spreadsheets. The rest of the chapter will concentrate on these packages. However, there are other types of application software that accounting can use. These include:

- databases for easy storage and retrieval of data and information. Accounting packages use databases to store data
- communications software that allows data and information to be communicated anywhere in the world through the use of a modem. These types of software include web browsers that allow access to the Internet and the World Wide Web.

Accounting packages

Because of the lower cost of computers and the greater complexity of recording as a result of the GST, the accounting tasks of a business are now usually computerised. Generally, the supplier sells this software either as a complete package or in various modules so that any business can pick and choose the right modules to suit its needs.

Examples available for smaller systems include MYOB, Reckon (see Figure 5.2), Xero and Sage. Accounting packages for large computer systems are often referred to as enterprise resource planning (ERP) systems and include SAP, Oracle (and PeopleSoft), Microsoft Dynamics and NetSuite.

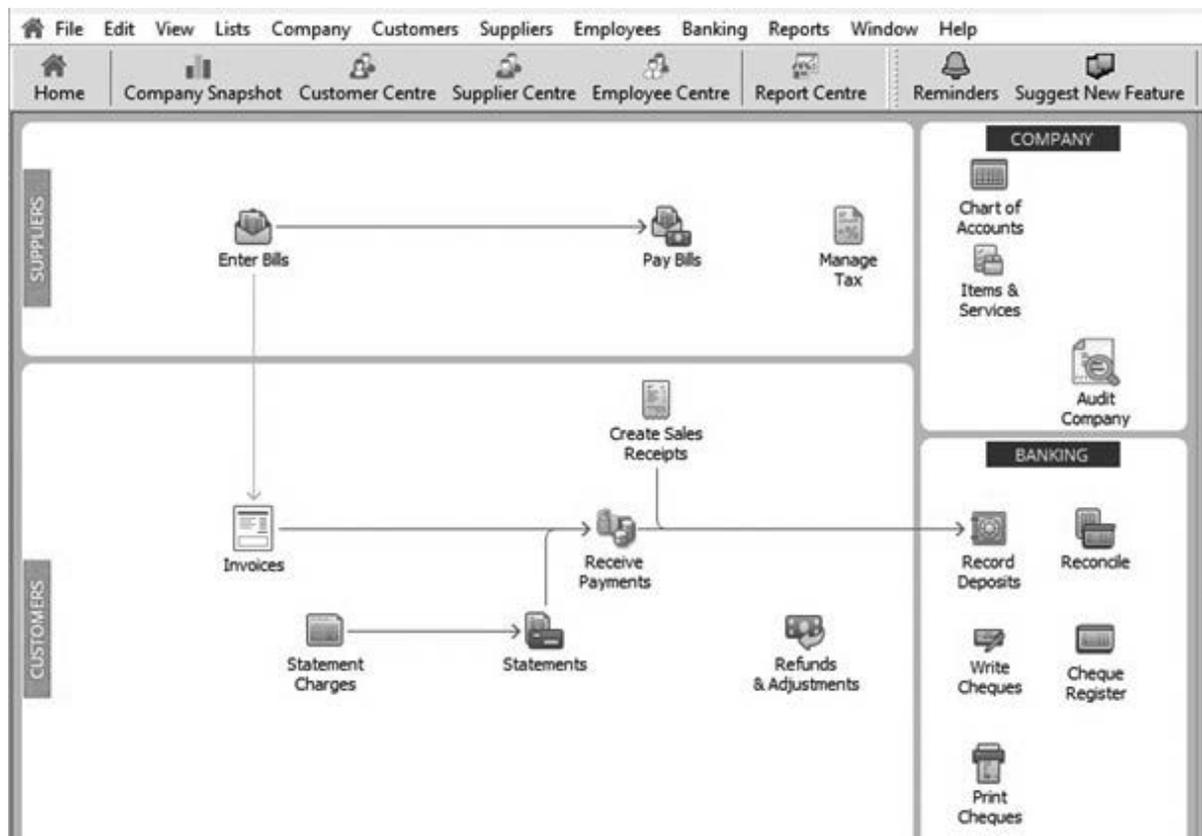


Figure 5.2 Reckon

Source: Reckon Limited

Some of the issues to be considered when choosing an accounting package are:

- **Online or desktop** – Is the application software stored on the desktop or accessed via the Internet anywhere in the world?
- **Storage** – Will the data be stored on the user's own system or 'in the cloud', which can be accessed via the Internet anywhere in the world?
- **Security and privacy** – If data are stored 'in the cloud' or at an external site, how secure and private are they?
- **Downloading data** – Can data, especially banking data, be downloaded easily and imported into the package? As we have already seen, the bank statement is a source document for many transactions and so facilities should exist to electronically download such data rather than manual entry.
- **Digital documents** – Can external source documents and correspondence be digitised/scanned and stored within the accounting system so that details relating to transactions are easily available?
- **Point-of-sale applications** – Do these allow data to be easily captured and electronically input into the accounting package? These applications are often seen in cafes and restaurants where catering staff use a tablet and an app.
- **Appropriate reporting tools** – Do these allow owners and managers to see in real time the position of their business and to solve queries and issues quickly and accurately?
- **Streaming applications** – Are applications available to see live streaming of the workplace? For example, if cameras are installed in critical places, can the owner/manager use the Internet to log in at any time and see what is happening?

Features of accounting packages

In this section we will discuss the features that are available on most accounting packages. Although particular packages may have extra features, the following are the most common.

Menu and/or graphical interface driven A menu is a list of options available to the user and is generally shown across the top of the screen. This allows the user to see the options available and to choose the one that is appropriate. An alternative is to have a graphical interface showing the various options with pictures, graphics and so on. Menus and graphical interfaces make the package much easier to use.

Modules The more common modules available are shown in Table 5.1. In MYOB and Reckon, the most common modules are bundled together.

Flexible chart of accounts Because the package can be used in a variety of businesses, it should be flexible enough to be able to cope with any chart of accounts, given certain limitations. For example, a package might indicate that all revenue and expenses must have numbers between 1 and 2999, while all assets, liabilities and owner's equity accounts must be numbered between 3000 and 6000. This provides great flexibility to the user because the accounts can be set up to suit the user and not be predetermined by the computer.

Audit trails In computer systems, most processing is done inside the machine. For audit purposes, some output must show every debit and credit entry that has taken place. This is the most common way in which entries can be verified by the auditor.

Security This ensures that only authorised personnel use the system. This is often achieved by the use of user names and passwords. Sometimes, multi-factor authentication (MFA) is used for greater security. This requires more than just a password. The system sends a code by text or email to a pre-registered mobile number or email address. That code must then be entered to access the system. As well, two levels of security are used – one for the data entry clerks who only have access to the data entry parts of the package, but not to the report functions; and another for entry to any part of the program, including reports.

Integration with other applications Because so much data are kept in the accounting system, it is desirable that the system be able to link with other applications such as email, spreadsheets, word-processing programs, databases, banking and so on. If the data can be used straight from the accounting package, it avoids the necessity of having to enter them into the other application packages.

Table 5.1 Common accounting modules/elements

Modules/Elements	Purpose	Output
Commonly used		
Accounts/General ledger	To keep main business records and determine financial results	General journal/Transaction listing Chart of accounts Ledger accounts Trial balance Statement of Profit or Loss/Profit and Loss Statement Statement of Financial Position/Balance Sheet
Banking	To record and control cash	Cash receipts listing/Transaction listing Cash payments listing/Transaction listing Undeposited funds Bank deposits Bank reconciliation Statement of Cash Flows
Customers/Sales/ Accounts receivable	To record amounts owing by customers and control overdue accounts	Tax invoices Adjustment notes Statements of account Accounts receivable list Aged analysis of accounts receivable
Suppliers/Purchases/ Accounts payable	To record amounts owed and ensure timely payment	Cheques Electronic payments Remittance advices Accounts payable list Aged analysis of accounts payable
Tax	To capture data for reporting goods and services tax (GST) requirements	GST Summary – cash and accrual GST Detail – cash and accrual
Inventories	To keep track of inventories and how much they are worth	Reorder report Over/under-stocked goods Quantity and valuation report Inventory list Price list Product sales report Outstanding purchase orders Future demands
Optional		
Payroll/Personnel	To pay employees the correct amount owing and keep track of deductions	Personnel records Payroll register Pay advice slips Payment summary Superannuation Staff lists
Non-current (long-term) assets	To record and control non-current assets	Schedule of non-current assets showing purchase dates, original cost and depreciation

Check for understanding

- 5.6 Name and **explain** the main features that should be available on accounting packages.
- 5.7 For each of the following modules, **explain** the main types of output:
- accounts/general ledger
 - banking
 - customers/sales/accounts receivable
 - suppliers/purchases/accounts payable
 - tax
 - inventories
- 5.8 Name the main features that are available on the accounting package you use.
-

Real-world accounting systems

In modern times, there are very few businesses that do not use computers. This book concentrates on conceptual accounting to emphasise the broad principles and concepts upon which accounting is based. This is so that you can apply these principles and concepts to any situation, be it a small sole trader running a coffee shop to a large organisation such as Woolworths or Coles. The following outlines some of the issues you should be aware of when comparing conceptual accounting with real-world computerised accounting systems.

Equipment In a computerised system, there is considerable cost in terms of hardware, software and the training of people to use the system. This initial cost is justified because it results in better control and more timely reporting.

Speed and accuracy of processing This is fundamental to a computerised system. The whole accounting process is carried out quickly and generally with great accuracy.

Basis of entry In the computer system, the chart of account numbers are the whole basis for the entry of data into the accounts. The use of a chart of accounts is imperative in a computer system.

Sequence of processing The conceptual accounting process you will learn in this book will remain the same. However, there are more considerations when a computer system is used, as Figure 5.3 shows.

Automatic postings In our conceptual system, every debit and credit entry must be physically posted individually. In a computer system, some entries, or parts of them, may be posted automatically:

- Once the transaction type is decided in the menu, the computer knows one of the relevant accounts for posting. Only the other half of the entry needs to be entered. For example, if a menu option for receipt of cash is chosen, the computer knows that every transaction will be a debit to the Cash at Bank account. Only the data for the other half of the transaction must be entered.
- If the same accounting entry is required every month (e.g. paying rent, insurance expense for month), it can be set up in a standing/recurring journal so that at the press of a key, the entries are automatically recorded.
- When ledgers for accounts receivable, accounts payable and inventories are used, all entries recorded in these ledgers are automatically recorded in the general ledger as well. (This will be discussed later in this chapter.)

Timely reports One of the main reasons for using a computer system is to be able to produce quality reports when required. With a computer system, these reports are available at the press of a key. They can be produced every day if necessary. However, this ability to produce reports easily can lead to a problem – having too much information that may not be relevant.

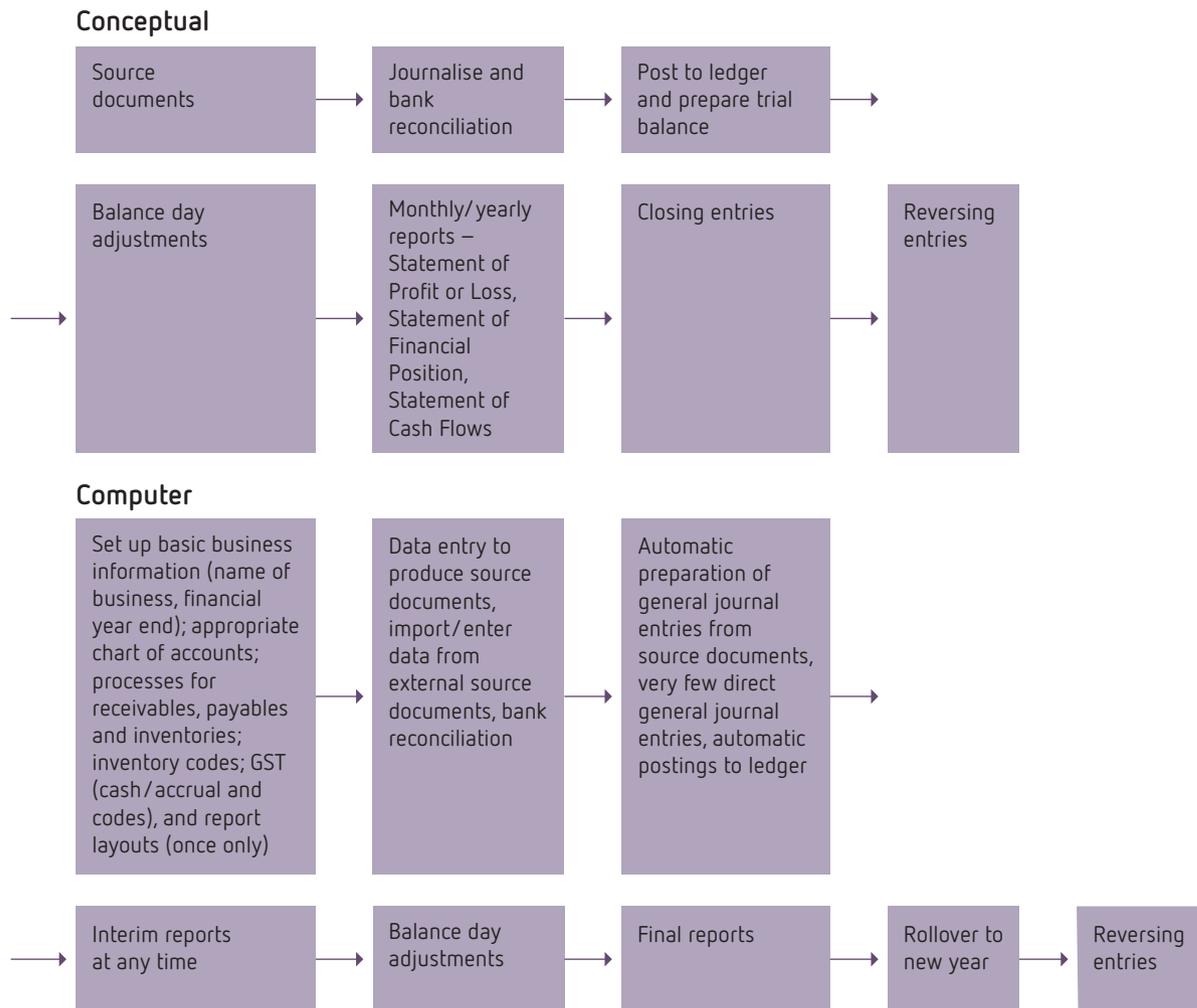


Figure 5.3 Sequence of processing under conceptual and computer accounting systems

Documents produced Without a computer, all documents have to be prepared by hand. The source document is then entered into the accounting process and so on through the system. The computer and other digital devices may allow the entry of details to produce the source document. These are then automatically posted to the ledger at the time the document is produced. The single data entry produces the document and also posts to the ledger. Common documents that can be produced include bank payments, receipts, tax invoices, adjustment notes and statements of account.

Omission of specialised journals Whenever a transaction occurs, we have shown it is first entered in the general journal. This journal is a major part of the recording process. However, in Chapter 4 on page 92, a brief mention was made that similar transactions such as cash receipts, cash payments and so on could be grouped and a specialised journal used for these transactions. In a computer system, this grouping is not necessary. Posting to the ledger from the general journal is so fast that the volume of data is not a problem. The need for any specialised journals is therefore eliminated. In the output phase, the accounting systems can print output showing the different groups of transactions in general journal form (see Table 5.1 on page 160). Alternatively, some audit trails are printed in groupings of similar transactions. These are merely reports and, as such, have no bearing on the input of data.

Control Computer accounting packages allow greater control over certain aspects of the business. Control allows the safeguarding of assets, ensures the accuracy and reliability of accounting data, promotes operational efficiency and encourages adherence to prescribed managerial policies. Examples of controls that could be implemented include:

- **Administrative control:** Timely data allow prompt action to correct any problems that may be occurring. Because all transactions can be entered almost immediately, the financial position of the firm at any point of time is always available. Computer packages also assist with staff control and appraisal through the generation of internal sectional or performance reports. These could take the form of a sales report by salesperson, or by region and so on.
- **Accounting control:** As will be discussed shortly, to safeguard the asset inventories, the perpetual system allows the owner to keep track of every item of inventory that enters and leaves the firm. Losses through theft and spoilage can always be calculated. Slow-moving items of stock can be found. Reordering lists will be generated when items reach minimum levels.

Computers also allow greater control by validating input, performing virtually error-free calculations and ensuring that debits always equal credits. As you have probably already discovered, this accuracy does not necessarily happen when people are doing the processing. However, the phrase ‘garbage in, garbage out’ is very relevant to any accounting system. If incorrect data are entered into the system, then the reports upon which that data are based will not be accurate. This is why many computer systems try to reduce the amount of manual data entry. At checkouts, barcodes are used to scan in products. This helps to reduce errors in the input phase.

Another example of accounting control is budgeting. Computer packages allow budgets to be entered so that actual figures can immediately be compared with budget figures to see if variances exist. Action can then be taken as soon as variances become too great.

As well, humans can use common sense when processing data. If something does not look correct, it can always be checked. However, a computer does not have an inbuilt intelligence – it blindly processes transactions. Computer systems must therefore have different types of internal control – input, processing, output and security controls – to ensure that fraud is not committed and errors are minimised.

Computers can fail It must be recognised that computer systems do fail. This can result from power failures, computer viruses and hacking, or problems in programming that cause systems to crash. Adequate backup and disaster recovery procedures are therefore essential in a computer system.

Accounting packages should not be seen as an end in themselves, but as a tool to enable more frequent, efficient and comprehensive analysis and interpretation of results for management and other interested parties.

Check for understanding

- 5.9 Briefly **describe** some of the main issues relating to operating a computerised accounting system.
- 5.10 Accounting packages are commonly available as a complete package or sold in modules. Accounting software for such elements as the general ledger, customers, suppliers and inventories is generally available, regardless of whether a single program or a number of modules is chosen.

Commercially available accounting packages that are available in Australia include MYOB, Reckon, Xero, Sage, SAP and Oracle. For three of these packages, ascertain the cost, how data are stored and the features that are available for each of the major elements plus one other element/module (e.g. payroll, non-current assets). You may wish to present the material in a table for easy comparison. A typical table is shown on the following page.

Comparison of accounting packages			
	Package 1	Package 2	Package 3
Cost			
Data storage			
General ledger			
Customers			
Suppliers			
Inventories			
Other			

To obtain this information, you may have to search online or read reviews published in computer or accounting magazines. Alternatively, you may wish to obtain brochures of the packages from computer software retailers that sell accounting packages.

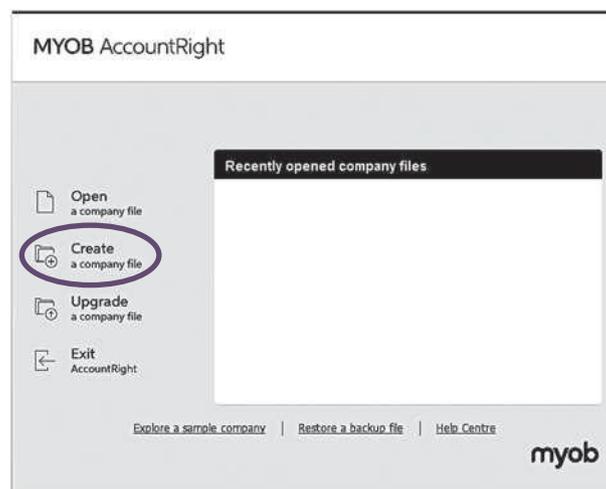
You should be able to conclude which package may be best for:

- a a small retailer who sells numerous inventory items
- b a cafe
- c an accountant
- d a large organisation such as Woolworths.

An introduction to MYOB AccountRight: general journal entries

Setting up

In order to begin entering transactions into an accounting package, the computer file for the business must be created. This is done by clicking on **Create** in the initial MYOB screen, as shown in Figure 5.4.



Source: MYOB

Figure 5.4 Introductory MYOB screen

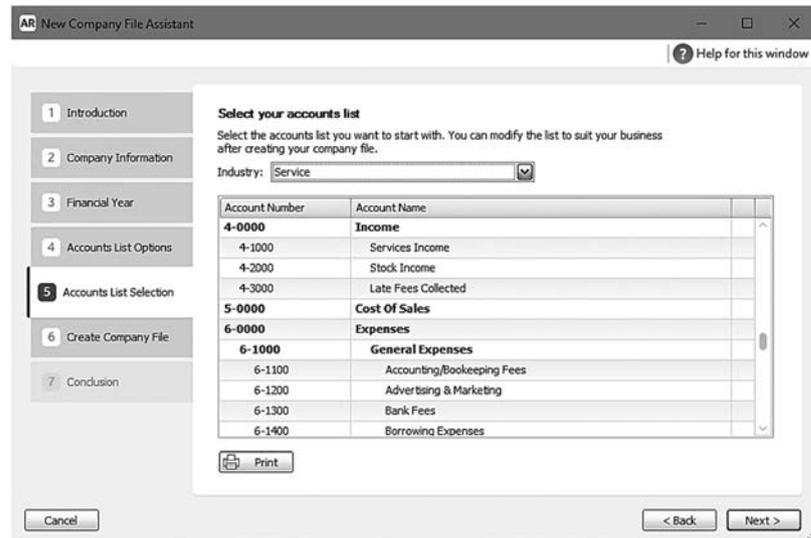
The computer will ask you to complete a series of steps relating to:

- product name of the software you are using (AccountRight Basics, Standard or Plus) and in what country the business is operating
- company information, including name and address of the business (as shown in Figure 5.5), to appear on all output
- financial year, including the ending month and year
- list of accounts used and whether MYOB will provide the list or import it from other software, or whether you will need to build your own list. Click list provided by MYOB
- list of accounts for the type of industry the business is operating in, as shown in Figure 5.6 (e.g. not-for-profit, service, retail and so on). **Service** will be chosen here.
- name of the file and where it will be saved.

Once the file has been created, you do not have to do these steps again. If you want to use the file to record transactions or see reports, then you use the **Open** option in Figure 5.4. As well, when you have finished using MYOB, it is very important that you close the program correctly, as an accounting package stores a lot of data and you don't want these data to be corrupted in any way. To close the program, use the **Exit** option in Figure 5.4 or click on the X in the very top right corner of the screen.

The screenshot shows the 'AR New Company File Assistant' window. On the left is a sidebar with seven steps: 1 Introduction, 2 Company Information (selected), 3 Financial Year, 4 Accounts List Options, 5 Accounts List Selection, 6 Create Company File, and 7 Conclusion. The main area is titled 'Enter your 12 digit MYOB product Serial Number' and has a text box for the serial number. Below this is a note: 'Your serial number is located on your registration card and on the back of your CD sleeve. Not required for trial version.' The next section is 'Enter information about your company' and includes text boxes for Company Name (marked with an asterisk), A.B.N., Address (with a scroll bar), Phone Number, Fax Number, and Email Address. A note at the bottom left of this section says '* Required field'. At the bottom of the window are three buttons: 'Cancel', '< Back', and 'Next >'. A 'Help for this window' button is in the top right corner. The source 'Source: Microsoft Corporation' is written vertically on the right side of the image.

Figure 5.5 Company information screen



Source: Microsoft Corporation

Figure 5.6 List of accounts used for the ledger in a service business

Entering transactions

After the initial setting up of the company, the following Command Centre main menu will appear as shown in Figure 5.7.



Source: Microsoft Corporation

Figure 5.7 MYOB main menu showing the Accounts command centre

In the **Accounts** command centre, there are three main items:

- **Accounts List**, which allows you to see all the accounts in the general ledger and to edit the name if required. The chart of accounts is the whole basis for entry into the general ledger. It is most important that these accounts and account numbers are correct, as they are also the basis of all reports coming from the system. Ensuring that these accounts are correct can be time consuming, but it is absolutely

essential. You will also create new accounts for the actual names of the accounts receivables and accounts payables; and, if they do not exist, the asset accounts for Supplies and Prepaid Insurance and the Supplies Expense account. You can do that at the beginning or when you enter the transactions in the general journal.

- Record Journal Entry, which enables you to record transactions in the general journal. If you click on this option, the screen shown in Figure 5.8 will appear.

Figure 5.8 Record journal entry

You are then able to make the entries in general journal format, showing the accounts to be debited and those to be credited. The total debits and credits will also be shown to see that debits equal credits.

- Transaction Journal, which allows you to see at any time what transactions have been entered. This is like the general journal you have learnt about previously. Make sure you enter the correct dates here for the transactions required.

Reports

One of the main reasons for having a computerised accounting system is that reports can be generated at any time. In Figure 5.7 along the bottom of the main menu, **Reports** can be selected. This will bring up a Reports screen as shown in Figure 5.9.

In the **Accounts** option and then the second **Accounts** option, the two important reports to be produced are the General Ledger [Detail] for the appropriate period and the Trial Balance. Further down, the Balance Sheet (Statement of Financial Position) and Profit and Loss Statement (Statement of Profit or Loss) are available and, under the Transaction Journals option, the General Journal can also be printed. A range of other reports can be produced, but these will be discussed later.

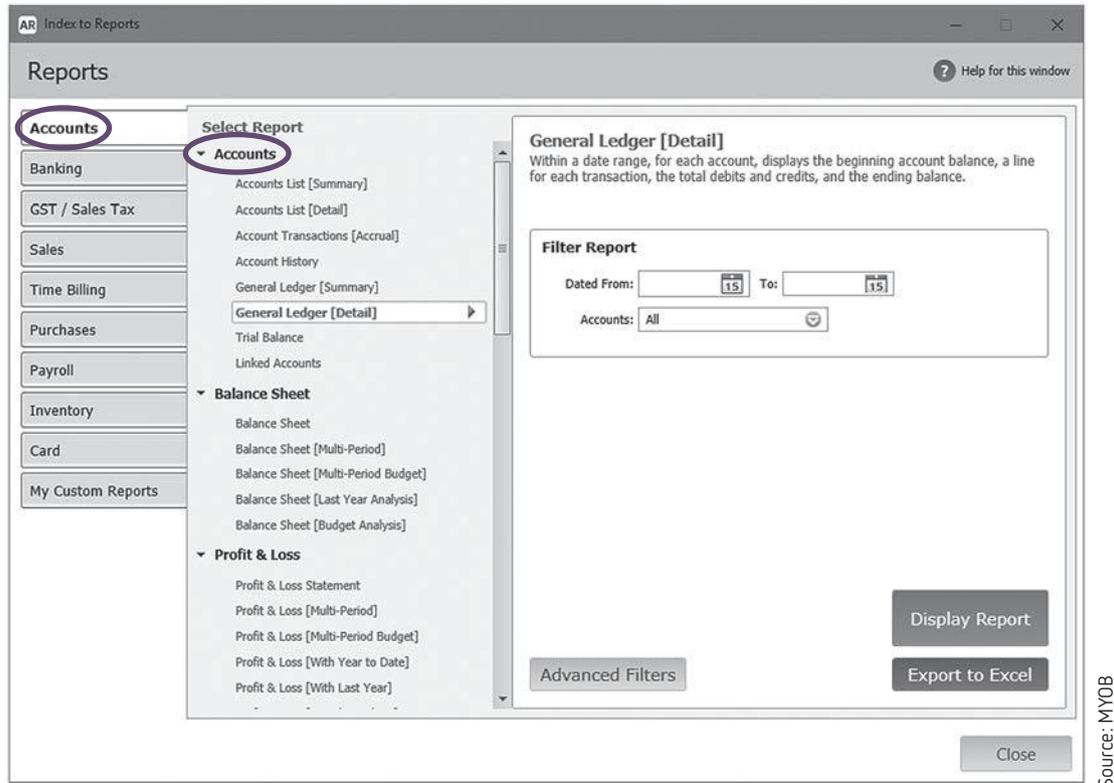


Figure 5.9 Report options

You now have an understanding of the basic processes to be performed to set up an accounting package, enter transactions into the general journal (later we will see we can enter a variety of transactions into different menu options) and print relevant reports.

There is one more important point to note. At various intervals, it is vital that the data file is **backed up** to a different place from where the data are being stored, preferably at a different site. If the file gets corrupted, or if there is a fire and your computer is destroyed, you will need to obtain that backup to begin operations again. To back up your file, use the **File** option and then **Back Up** in the main menu.

If something happens to your data file and you have to open a back up file, use the **File** option and then **Restore** in the main menu.

Check for understanding

- 5.11 In Questions 4.21, 4.22 and 4.23, you already prepared the solution manually. Now, **prepare** the solution on the computer using an accounting package such as MYOB or Reckon. Enter all transactions into the general journal section of the package. Print out the ledger and the trial balance. Compare the results with the answers you prepared previously. **Explain** the advantages of using the computer system. Are there any disadvantages?
-

Accounting packages: control accounts and subsidiary ledgers

In Chapter 4, you were shown how to account for the GST. At the end of this chapter, you will be required to use menu options in an accounting package as if you were operating in the real world. You will set up the accounting package so that the recording of transactions involving the GST, accounts receivable, accounts payable and inventories is simple and efficient.

However, it is important that you understand what actually occurs when you process these transactions in an accounting package. You must have a conceptual understanding of what should happen. Accounting packages use subsidiary ledgers and control accounts with accounts receivable, accounts payable and inventories. The aim of this section is not only to use an accounting package to process transactions with the GST into subsidiary ledgers, but also to understand conceptually what happens to the subsidiary ledgers inside the package as a result of that processing.

As should be apparent so far, a major aim of the accounting process is to take repetitive information out of the ledger. A technique for deleting unnecessarily detailed information from the ledger is the use of control accounts and subsidiary ledgers. This technique changes the whole structure of the ledger itself.

Up to now, we have used only one ledger in which every account has been kept. This is acceptable for a small business having few accounts, particularly few accounts receivable or accounts payable. This type of ledger could not, however, cope with the demands placed on it by a large business. A more efficient method of recording is required for this.

When accounting for accounts receivable and accounts payable, a business would have three ledgers: the general ledger and two subsidiary ledgers.

A general ledger is the main ledger of the business from which the trial balance is prepared.

A subsidiary ledger is a separate detailed ledger containing a group of accounts of a like nature that have been removed from the general ledger and replaced by a control account.

Therefore the business would have two separate subsidiary ledgers: one called the Accounts Receivable ledger (where all accounts receivable or trade debtors accounts are kept), and one called the Accounts Payable ledger (where all accounts payable or trade creditors accounts are kept). These ledgers record the individual accounts receivable and payable accounts, and the detailed information relating to those individual accounts. (Other types of subsidiary ledgers could be kept for inventories and non-current assets. These will be dealt with later.)

The general ledger will change in two ways:

- 1 There will be no individual Accounts Receivable or Accounts Payable accounts.
- 2 Two new control accounts will be introduced for the deleted Accounts Receivable and Accounts Payable accounts.

This means that each whole subsidiary ledger is represented by one total account in the general ledger called a control account. In this modern age of computers where accounting systems are in real time and up to date, transactions are generally recorded at the time of the transaction. This means that whenever the amounts are posted to the subsidiary ledger, the individual amounts are also posted to the control account in the general ledger. The control account for the Accounts Receivable ledger is known as the Accounts Receivable Control account or Debtors Control account. The control account for the Accounts Payable ledger is known as the Accounts Payable Control account or Creditors Control account.

Accounting for control accounts and subsidiary ledgers for accounts receivable and accounts payable

It is easy to become confused in this section of work because it sometimes appears that entries might have two debits and only one credit, or vice versa. However, the double-entry principle is still maintained within the general ledger. The extra debit or credit entry is only recorded in the subsidiary ledger. This is done so that we know how much the business owes or how much is owing to the business on each individual account at any point in time.

Two basic rules must be followed to record transactions correctly:

- Rule 1** In the general ledger, the double-entry principle is adhered to – total debit must always equal total credit.
- Rule 2** Whatever is posted to either side of the control account in the general ledger must also be posted in detail to the same side of the individual accounts in the subsidiary ledger.

Always remember that the trial balance is only taken from the general ledger, where debits will always equal credits.

Illustrative example 1: Accounts payable only

From the information given in the following Statement of Financial Position and source documents, show the general and accounts payable ledgers. Also prepare a Trial Balance and Accounts Payable Listing.

General Ledger

Apex Industries General Ledger			
Date	Particulars	Dr	Cr
		\$	\$
Cash at Bank			
Apr 1	Balance ^a		50 000 Dr
29	Condor	300 ^e	49 700 Dr
29	Portra	1300 ^f	48 400 Dr
Inventories			
Apr 1	Balance ^a		16 000 Dr
10	Purch Monto	5 000 ^b	21 000 Dr
17	Purch Portra	2 300 ^c	23 300 Dr
22	Ret Monto		22 630 Dr
Accounts Payable Control			
Apr 1	Balance ^a		3 000 Cr
10	Purch Monto	5 500 ^b	8 500 Cr
17	Purch Portra	2 300 ^c	10 800 Cr
22	Ret Monto	737 ^d	10 063 Cr
29	Cash Condor	300 ^e	9 763 Cr
29	Cash Portra	1 300 ^f	8 463 Cr
GST Credits Received			
Apr 10	Purch Monto	500 ^b	500 Dr
22	Ret Monto		433 Dr
			67 ^d
Capital			
Apr 1	Balance ^a		63 000 Cr

Apex Industries Trial Balance as at 30 April			
Account number	Account	Debit	Credit
		\$	\$
3103	Cash at Bank	48 400	
3106	Inventories	22 630	
4101	Accounts Payable Control		8 463
4102.2A	GST Credits Received	433	
5101	Capital		63 000
		<u>71 463</u>	<u>71 463</u>

Information

Statement of Financial Position ^a as at 31 March	
Cash at Bank	50 000
Inventories	16 000
Accts Pay:	
Condor Co	300
Portra Ltd	1 300
Monto Whol	1 400
	<u>3 000</u>
Capital	63 000
	<u>\$66 000</u>

**Monto Wholesalers^b
Tax Invoice**
No 215 10 April 2026
To: Apex Industries \$5500*
* GST included
Purchased goods from Monto
Wholesalers \$5500 including GST

**Portra Ltd^c
Tax Invoice**
No 893 17 April 2026
To: Apex Industries \$2300
Bought GST-free inventories from
Portra Ltd \$2300

**Monto Wholesalers^d
Adjustment Note**
No 172 22 April 2026
To: Apex Industries \$737*
* GST included
Returned goods to Monto
Wholesalers \$737 including GST

**XYZ Bank^e
Electronic Payment**
Payer name: Apex Industries
Amount: \$300
Payment Date: 29 April 2026
Description: Condor Co
Payment No: 332452
Paid Condor Co \$300

**XYZ Bank^f
Electronic Payment**
Payer name: Apex Industries
Amount: \$1300
Payment Date: 29 April 2026
Description: Portra Ltd
Payment No: 227452
Paid Portra Ltd \$1300

Accounts Payable Subsidiary Ledger

Apex Industries Accounts Payable Ledger			
Date	Particulars	Dr	Cr
		\$	\$
Condor Co			
Apr 1	Balance ^a		300 Cr
29	Cash	300 ^e	0 Cr
Portra Ltd			
Apr 1	Balance ^a		1 300 Cr
17	Purch		2 300 ^c
29	Cash	1 300 ^f	2 300 Cr
Monto Wholesalers			
Apr 1	Balance ^a		1 400 Cr
10	Purch		5 500 ^b
22	Return	737 ^d	6 900 Cr
			6 163 Cr

Apex Industries Accounts Payable Listing as at 30 April			
Report		Dr	Cr
		\$	\$
4101.2	Portra Ltd		2 300 Cr
4101.3	Monto Wholesalers		6 163 Cr
	Balance as per Control Account		<u>\$8 463 Cr</u>

If you follow the letters for each transaction, you will see how the rules are applied:

Rule 1	Debit equals credit in the general ledger
Rule 2	Whatever is posted to either side of the control account in the general ledger is also posted in detail to the same side of the individual accounts in the subsidiary ledger.

As you proceed line by line through the transactions, tick each entry in the ledger. That way you will see what is happening in the recording process.

Posting to the ledger			
a	1 April Statement of Financial Position		
	Balances in the relevant ledger accounts in the general ledger	<i>Rule 1</i>	
	Cash at Bank	Dr	50 000
	Inventories	Dr	16 000
	Accounts Payable Control	Cr	3 000
	Capital	Cr	63 000
	Individual balances for accounts payable shown in the subsidiary ledger	<i>Rule 2</i>	
	Condor Co	Cr	300
	Portra Ltd	Cr	1 300
	Monto Wholesalers	Cr	1 400
b	10 April Purchase Tax Invoice		
	Inventories	Dr	5 000
	GST Credits Received	Dr	500
	Accounts Payable Control (Monto Wholesalers)	Cr	5 500
			<i>Rule 1</i>
			<i>Rule 2</i>
c	17 April Purchase Tax Invoice		
	Inventories	Dr	2 300
	Accounts Payable Control (Portra Ltd)	Cr	2 300
			<i>Rule 1</i>
			<i>Rule 2</i>
d	22 April Purchases Return Adjustment Note		
	Accounts Payable Control (Monto Wholesalers)	Dr	737
			<i>Rule 2</i>
	GST Credits Received	Cr	67
	Inventories	Cr	670
			<i>Rule 1</i>
e	29 April Online Payment		
	Accounts Payable Control (Condor Co)	Dr	300
			<i>Rule 2</i>
	Cash at Bank	Cr	300
			<i>Rule 1</i>
f	29 April Online Payment		
	Accounts Payable Control (Portra Ltd)	Dr	1 300
			<i>Rule 2</i>
	Cash at Bank	Cr	1 300
			<i>Rule 1</i>

Notice that the only difference with the control account/subsidiary ledger technique is that it would appear that we are making two entries for the accounts payable. This is true, but note that only one of the entries is made in the general ledger so that double entry is maintained. The other is made in the subsidiary ledger. Remember the two basic rules and the technique should work correctly.

As a further control to check if the recording has been completed accurately (and that Rule 2 has been completed), an **Accounts Payable Listing** is prepared. This is simply a list of individual account balances obtained from the Accounts Payable ledger. The total of these account balances should equal the balance in the Accounts Payable Control account. If the listing and the balance of the control account do not reconcile, an error has been made and appropriate steps should be taken to fix the problem.

To show that these rules have been applied correctly, Rule 1 means that the Trial Balance should be equal, which it is with a total of \$71 463 for the debit and credit columns. Rule 2 shows the Accounts Payable Listing totals \$8463, which matches the credit balance in the Accounts Payable Control account of \$8463. All is correct.

Check for understanding

5.12 You are given the following ledger accounts.

Nguyan Enterprises				
General Ledger				
Date	Particulars	Dr	Cr	Balance
		\$	\$	\$
Inventories				No 3106
Sep 1	Balance			27 000 Dr
11	Purchase Maverin	9 600		36 600 Dr
20	Purchase Linus	5 800		42 400 Dr
22	Return Maverin		340	42 060 Dr
Accounts Payable Control				No 4101
Sep 1	Balance			12 000 Cr
11	Invent Maverin		10 560	22 560 Cr
20	Invent Linus		5 800	28 360 Cr
21	Cash Augar	7 600		20 760 Cr
22	Return Maverin	374		20 386 Cr
30	Cash Harvour	4 720		15 666 Cr

- a **Analyse** the accounts and for each entry, **describe** what has happened (including GST).
- b What should the balance of the Accounts Payable Control account match?

5.13 The following is information about the business of Mirza Industries.

- a **Post** the information to the general and accounts payable columnar ledgers and **prepare** a trial balance (no journal entries are required).
- b **Prepare** an accounts payable listing at 31 March.

Purchases for the month:

Date	Accounts payable	Purchases including GST	GST
		\$	\$
Mar 3	Smith Ltd	605	55
16	Monessey Ltd	902	82

Purchases returns for the month:

Date	Accounts payable	Returns including GST	GST
		\$	\$
Mar 18	Monessey Ltd	253	23

Cash payments for the month:

Date	Particulars	Cash Paid	GST
		\$	\$
Mar 2	Smith Ltd	300	
	Purchases	407	37
12	Advertising	231	21
28	Haliday Pty Ltd	700	

Accounts Payable balances at 28 February		\$
Smith Ltd		300
Haliday Pty Ltd		700
C Friedman		250
		<u>\$1 250</u>

General Ledger balances at 28 February		\$
Cash at Bank		25 400
Accounts Payable		1 250
Capital		24 150

Illustrative example 2: Accounts receivable only

From the information given in the Statement of Financial Position and source documents on the following pages, show the general and accounts receivable ledgers. Also prepare a Trial Balance and Accounts Receivable Listing.

General Ledger

Fragor Enterprises
General Ledger

Date	Particulars	Dr \$	Cr \$	Balance
Sales				No 1101
July 3	Knowles	2 540 ^b		2 540 Cr
10	Meanjin	1 400 ^c		3 940 Cr
15	Broven Bros	230 ^d		4 170 Cr
Sales Returns				No 1101A
July 29	Broven Bros	50 ^g		50 Dr
Cost of Goods Sold				No 2105
July 3	Inventories	1 620 ^b		1 620 Dr
10	Inventories	840 ^c		2 460 Dr
15	Inventories	170 ^d		2 630 Dr
29	Inventories	30 ^g		2 600 Dr
Cash at Bank				No 3103
July 1	Balance ^a		40 000	Dr
21	T Knowles	1 600 ^e		41 600 Dr
28	Meanjin	3 100 ^f		44 700 Dr
Accounts Receivable Control				No 3104
July 1	Balance ^a		5 900	Dr
3	Sales Knowles	2 794 ^b		8 694 Dr
10	Sales Meanjin	1 400 ^c		10 094 Dr
15	Sales Broven	253 ^d		10 347 Dr
21	Cash Knowles	1 600 ^e		8 747 Dr
28	Meanjin	3 100 ^f		5 647 Dr
29	Ret Broven	55 ^g		5 592 Dr
Inventories				No 3106
July 1	Balance ^a		25 000	Dr
3	COGS	1 620 ^b		23 380 Dr
10	COGS	840 ^c		22 540 Dr
15	COGS	170 ^d		22 370 Dr
29	COGS	30 ^g		22 400 Dr
GST Collected				No 4102.2
July 3	Sales Knowles		254 ^b	Cr
15	Sales Broven		23 ^d	Cr
29	Ret Broven		5 ^g	Cr
Capital				No 5101
July 1	Balance ^a		70 900	Cr

Information

**Statement of Financial Position^a
as at 30 June**

Cash at Bank	40 000
Accounts Receivable:	
T Knowles Ltd	1 600
Meanjin Traders	3 100
Broven Bros	1 200
Inventories	5 900
	<u>25 000</u>
Capital	70 900
	<u>\$70 900</u>

**Fragor Enterprises^b
Tax Invoice**

No 349 3 July 2026
To: T Knowles Pty Ltd \$2794*
* GST included

Sold goods to T Knowles Pty Ltd for \$2794 GST included. Cost price of goods was \$1620

**Fragor Enterprises^c
Tax Invoice**

No 350 10 July 2026
To: Meanjin Traders \$1400

Sold GST-free goods to Meanjin Traders for \$1400 cost price being \$840

**Fragor Enterprises^d
Tax Invoice**

No 351 15 July 2026
To: Broven Bros \$253*
* GST included

Sold goods to Broven Bros for \$253 GST included. Cost price of goods was \$170

Accounts Receivable Subsidiary Ledger

Fragor Enterprises
Accounts Receivable Ledger

Date	Particulars	Dr \$	Cr \$	Balance
T Knowles Ltd				No 3104.1
July 1	Balance ^a			1 600 Dr
3	Sales	2 794 ^b		4 394 Dr
21	Cash		1 600 ^e	2 794 Dr
Meanjin Traders				No 3104.2
July 1	Balance ^a			3 100 Dr
10	Sales	1 400 ^c		4 500 Dr
28	Cash		3 100 ^f	1 400 Dr
Broven Bros				No 3104.3
July 1	Balance ^a			1 200 Dr
15	Sales	253 ^d		1 453 Dr
29	Return		55 ^g	1 398 Dr

Information

Fragger Enterprises Trial Balance as at 31 July			
Account number	Account	Debit \$	Credit \$
1101	Sales		4 170
1101A	Sales Returns	50	
2105	Cost of Goods Sold	2 600	
3103	Cash at Bank	44 700	
3104	Accounts Receivable	5 592	
	Control		
3106	Inventories	22 400	272
4102.2	GST Collected		70 900
5101	Capital		<u>75 342</u>
		<u>\$75 342</u>	<u>\$75 342</u>

Fragger Enterprises Accounts Receivable Listing as at 31 July	
Report	
3104.1	T Knowles Ltd 2 794 Dr
3104.2	Meanjin Traders 1 400 Dr
3104.3	Broven Bros <u>1 398 Dr</u>
	Balance as per Control Account <u>\$5 592 Dr</u>

Statement of Account (Extract) ABC Bank		Credit
Fragger Enterprises		
July 21 Deposit on line		1600 ^e
241289 T Knowles Ltd		
July 28 Deposit on line		3100 ^f
348112 Meanjin Traders		

Fragger Enterprises ^a Adjustment Note	
No 112	29 July 2026
To: Broven Bros	\$55*
	* GST included

Broven Bros returned goods for \$55
GST included. Cost price of goods
was \$30

If you follow the letters for each transaction, you will see how the rules are applied:

Rule 1	Debit equals credit in the general ledger
Rule 2	Whatever is posted to either side of the control account in the general ledger is also posted in detail to the same side of the individual accounts in the subsidiary ledger.

As you proceed line by line through the transactions, tick each entry in the ledger. That way you will see what is happening in the recording process.

Posting to the ledger			
a	1 July Statement of Financial Position		
	Balances in the relevant ledger accounts in the general ledger	<i>Rule 1</i>	
	Cash at Bank	Dr	40 000
	Accounts Receivable Control	Dr	5 900
	Inventories	Dr	25 000
	Capital	Cr	70 900
	Individual balances for accounts receivable shown in the subsidiary ledger	<i>Rule 2</i>	
	T Knowles Ltd	Dr	1 600
	Meanjin Traders	Dr	3 100
	Broven Bros	Dr	1 200
b	3 July Sales Tax Invoice		
	Accounts Receivable Control (T Knowles Ltd)	Dr	2 794
	GST Collected	Cr	254
	Sales	Cr	2 540
	Cost of Goods Sold	Dr	1 620
	Inventories	Cr	1 620
c	10 July Sales Tax Invoice		
	Accounts Receivable Control (Meanjin Traders)	Dr	1 400
	Sales	Cr	1 400
	Cost of Goods Sold	Dr	840
	Inventories	Cr	840
d	15 July Sales Tax Invoice		
	Accounts Receivable Control (Broven Bros)	Dr	253
	GST Collected	Cr	23
	Sales	Cr	230
	Cost of Goods Sold	Dr	170
	Inventories	Cr	170
e	21 July Online Deposit		
	Cash at Bank	Dr	1600
	Accounts Receivable Control (T Knowles Ltd)	Cr	1600

Posting to the ledger					
f	28 July Online Deposit				
	Cash at Bank	Dr	3100		
	Accounts Receivable Control (Meanjin Traders) <i>Rule 2</i>	Cr		3100	<i>Rule 1</i>
g	29 July Sales Return Adjustment Note				
	Sales Returns	Dr	50		
	GST Collected	Dr	5		
	Accounts Receivable Control (Broven Bros) <i>Rule 2</i>	Cr		55	<i>Rule 1</i>
	Inventories	Dr	30		
	Cost of Goods Sold	Cr		30	

After looking at the posting to the ledgers, go through and check that both Rules 1 and 2 have been followed. Get into the habit of doing this to make sure that you understand what is happening and are not simply rote learning.

Notice that the only difference with the control account/subsidiary ledger technique is that it would appear that we are making two entries for the accounts receivable. This is true, but note that only one of the entries is made in the general ledger so that double entry is maintained. The other is made in the subsidiary ledger. Remember the two basic rules and the technique should work correctly.

Notice that for ease of processing, we have joined together in one entry the selling price of the sale and the cost price of the sale. This approach is generally adopted in computerised accounting packages.

As a further control to check if the recording has been completed accurately (and that Rule 2 has been completed), an **Accounts Receivable Listing** is prepared. This is simply a list of individual account balances obtained from the Accounts Receivable ledger. The total of these account balances should equal the balance in the Accounts Receivable Control account. If the listing and the balance of the control account do not reconcile, an error has been made and appropriate steps should be taken to fix the problem.

To show that the rules have been applied correctly, Rule 1 means that the Trial Balance should be equal, which it is with a total of \$75 342 for the debit and credit columns. Rule 2 shows the Accounts Receivable Listing totals \$5592, which matches the debit balance in the Accounts Receivable Control account of \$5592. All is correct.

Advantages of control accounts

As you are now familiar with the control account/subsidiary ledger technique, the advantages listed may be obvious:

- 1 A trial balance can be prepared without referring to the subsidiary ledgers. This emphasises that double entry occurs only in the general ledger. The accounts in the subsidiary ledgers do not form part of the double-entry system.
- 2 In the preparation of financial reports, the control accounts provide a summary of the accounts receivable and accounts payable.
- 3 Errors can be detected through the use of control accounts. If the accounts receivable and accounts payable listings do not agree with the balances in the control accounts, a mistake has been made.

Check for understanding

5.14 You are given the following ledger accounts.

Blum Industries General Ledger				
Date	Particulars	Dr	Cr	Balance
		\$	\$	\$
Sales				No 1101
Dec 4	Keller		8 200	8 200 Cr
11	Gimuy		12 400	20 600 Cr
22	Zavier		6 200	26 800 Cr
Accounts Receivable Control				No 3104
Dec 1	Balance			9 200 Dr
4	Sales Keller	9 020		18 220 Dr
11	Sales Gimuy	12 400		30 620 Dr
21	Cash Keller		3 100	27 520 Dr
22	Sales Zavier	6 820		34 340 Dr
29	Sales Return Zavier		660	33 680 Dr
Inventories				No 3106
Dec 1	Balance			32 000 Dr
4	COGS		5 100	37 100 Dr
11	COGS		8 150	45 250 Dr
22	COGS		2 860	48 110 Dr
29	COGS	300		47 810 Dr

- a **Analyse** the accounts and for each entry, **describe** what has happened (including GST).
- b What should the balance of the Accounts Receivable Control account match?

- 5.15 The following is information about the business of Lin Materials, on the basis of which you are required to:
- post** the information to the columnar ledgers (Lin has a separate ledger for accounts receivable) and **prepare** a trial balance
 - prepare** an accounts receivable listing at 31 January.
- (Note: If you think the general journal helps in your understanding of the process, prepare one as rough workings.)

General Ledger accounts as at 1 January		\$
Accounts Receivable		2 900
Inventories		23 000
Capital		25 900

Accounts Receivable balances at 1 January		\$
C Muller		900
Noel Industries		850
Wilson & Sons		600
A Graham		550
		<u>\$2 900</u>

Credit sales for month:

Date	Accounts Receivable	Sales including GST \$	GST \$	Cost \$
Jan 12	Frank Ltd	770	70	450
14	A Graham	400		180

Sales returns for the month:

Date	Accounts Receivable	Returns including GST \$	GST \$	Cost \$
Jan 15	A Graham	60		25

Cash receipts for the month:

Date	Particulars	Cash received \$	GST \$	Cost \$
Jan 1	C Muller	900		
4	Interest	200		
5	Sales	440	40	186
28	Noel Industries	850		

- 5.16 How does the general ledger change when subsidiary ledgers are introduced?
- 5.17 When accounting for subsidiary ledgers, what rules must be observed to enable the correct recording to take place?
- 5.18 To ensure appropriate control over the recording of subsidiary ledgers for accounts receivable and accounts payable, which three reports are prepared? Which figures must be compared to help ensure accurate recording?

Accounting packages: inventories

Many businesses buy and sell inventories (sometimes called stock, goods or merchandise) in order to make a profit.

Inventories are items held for sale in the ordinary course of the normal operations of the business.

This definition emphasises the fact that an item must be held for sale in the ordinary course of business. The purpose for which items are bought therefore determines whether or not they are inventories. For example, the purchase of office machines could be inventories in one business and long-term assets in another. If a business bought and sold office machines as part of its ordinary operations, the purchase of a photocopier would be considered as inventory. If, however, a business bought a new photocopier for its own use over a long period of time, it would be considered a long-term or non-current asset.

The following businesses would therefore have different items that would be called inventories:

Business	Inventories
Retail store	Foodstuffs, clothing, hardware, electrical goods, sporting goods
Furniture wholesaler	Furniture
Electrical retailer	Electrical goods
Car dealer	Motor vehicles
Pastoralist	Sheep, cattle, horses, pigs
Mining company	Coal, iron ore, silver
Manufacturer	Raw materials, work in progress, finished goods

Most of the items listed are finished goods ready for sale. However, a manufacturing business must make the products. At any point in time for a manufacturer, there will be items that are finished and ready for sale (finished goods), items that are only partly completed (work in progress) and items that have not yet been used in the production process (raw materials). All of these items are considered by the manufacturer to be inventories.

A further definition of inventories, as set out in Accounting Standard AASB 102, would include those assets:

- a held for sale in the ordinary course of business
- b in the process of production for such sale, or
- c in the form of materials or supplies to be consumed in the production process or in the rendering of services.

In this book, however, most of the examples dealing with inventories involve businesses in which finished goods are bought for resale. As well, you have already seen how supplies mentioned in part c of the definition above are treated as an asset. However, they are normally given their own asset account, called Supplies or Consumable Supplies, so they are kept separate from inventories that are bought for the specific purpose of resale.

When supplies are purchased, they are debited to the asset Supplies account, and when inventories are purchased, they are debited to the asset Inventories account. When supplies are used, they are debited to a Supplies Expense account and credited to Supplies. When inventories are sold, they are debited to a Cost of Goods Sold account (an expense) and credited to Inventories. The conceptual bases for these debit/credit entries for both assets are therefore the same.

Check for understanding

- 5.19 a Define the term ‘inventories’.
- b **Identify** examples of items that could be inventories in one business and long-term assets in another.
- c **Explain** why sheep and cattle are classified as inventories for a pastoralist.
- d Name some other terms that can be used instead of ‘inventories’.
-

Perpetual inventory system

Two systems of accounting for inventories are available: the **periodic inventory system** and the **perpetual inventory system**. As most businesses will have an electronic inventory system, the periodic inventory system is not often implemented. The periodic inventory system will be discussed in Chapter 6 in relation to end-of-year reporting and supplies.

Because the perpetual inventory system allows much greater control over the asset Inventories, this system is generally recognised to be the best. It relies heavily on computers to do the recording, processing and calculations, and allows up-to-date inventory information to be readily available. It is also the system used throughout this book.

You have previously learnt that whenever a sale takes place, two prices must be recorded:

- the selling price, which is recorded as a debit to the Accounts Receivable or Cash Account depending upon whether the transaction was on credit or for cash; and a credit to the Sales account to record the increase in revenue
- the cost price, which results in a debit to Cost of Goods Sold as that was the cost of that particular item sold; and a credit to Inventories as the item has been sold and so inventories have decreased.

A similar situation occurs with sales returns, but of course the entries are reversed.

Given this, have you wondered how the cost price of the goods being sold is determined? Up to this point, the cost price has always been given to you. However, in the real world, businesses require a method to determine the cost price of every inventory item sold.

Inventory costing methods

To prepare the Statement of Financial Position, Statement of Profit or Loss and other reports, it is necessary to determine both the cost of inventories that are sold and the cost of inventories on hand.

In order to determine these costs, it is necessary to first work out what ‘cost’ actually means. Cost¹ in relation to inventories is the aggregate of the:

- purchase price
- customs duty and other import duties and taxes
- inwards transport and handling costs
- other costs (such as repackaging) incurred in bringing the inventories to their present location and into condition ready for sale.

Next, it is necessary to decide what inventory costing method is applicable to each particular business. A costing method must be used to determine the cost of goods sold and the cost of inventories on hand. This decision needs to be made because inventories may have been purchased at different times and at different costs during the period.

The most common methods used in Australia to make this decision are now discussed.

Specific identification

The specific identification method assumes that it is practicable to trace the cost price of each item at all times. This is done by looking up computer records or by placing a code on the price tag. The method is suitable for use with goods that stay in their original form and are easily identifiable – general retail inventories, motor vehicles, furniture and the like. It is the ideal method for determining cost price for all types of inventories.

However, not all inventories are easily identifiable. What happens with items such as petrol, paint and kerosene stored in bulk containers? Or small items such as nails in a hardware store? Or potatoes at a greengrocer? In each of these cases it is impractical to identify an individual cost price. For example, how could you determine the exact cost price of a litre of petrol if the bulk container had been topped up three times at three different prices?

Accountants must therefore choose one of the other methods to establish the cost price of such items. Generally, the accountant would choose the method in which the physical flow of goods and the resultant cost flow correspond.

First-In First-Out (FIFO)

Under the FIFO method, it is assumed that the first items to come into the business are the first items to go out of the business. The method has the following results:

- The cost attributed to the sale is the cost of the first inventories purchased.
- Inventory cost on hand represents the last purchases.

Because prices change, the quantity of items purchased at each different price must be tracked so that the oldest items are sold first.

1 For a more detailed explanation, see Accounting Standard AASB 102 Inventories. The figure for purchases (and thus inventories) should include all these relevant costs. Many businesses are fortunate in being able to include these costs as the purchase occurs; that is, they are treated as product costs. However, this is not possible or convenient in all cases. If these costs are not included when the purchase occurs, a problem will exist at year end when these costs must be apportioned to both cost of goods sold and the inventories on hand.

For reasons of materiality, firms usually decide on one of two approaches:

- treat all expenses (customs duty, freight and so on) as a period cost and therefore write them off to cost of goods sold
- apportion some part of the expenses to cost of goods sold and some part to inventories.

Each firm would have to decide its approach on the basis of its own situation. Considerations such as materiality and practicality would have to be taken into account. In this book, we have adopted the first approach for ease of learning.

The stock items are also useful in ensuring that adequate quantities of inventories are on hand ready for sale. Whenever the quantity on hand reaches the reorder point, more goods are ordered. The reorder point and the reorder quantity are reviewed periodically in keeping with current demand for the item.

The stock item in Illustrative example 3 was prepared using the weighted average cost method under a perpetual inventory system to illustrate the effect of the method.

Illustrative example 3

On 1 July, the balance on hand of product X, code number 7426, was 80 units at \$10 per unit.

Purchases		
July	6	250 units @ \$11 per unit.
	15	100 units @ \$13 per unit.
	24	170 units @ \$14 per unit.

Sales		
July	8	270 units @ \$20 per unit.
	13	40 units @ \$20 per unit.
	26	140 units @ \$20 per unit.

Stock Item										
Description Product X					Stock no 7426					
Maximum quantity 400					Reorder point 100					
Minimum quantity 20					Reorder quantity 100–250					
Date	Particulars	In			Out			Balance		
		Qty	Unit cost \$	Total cost \$	Qty	Unit cost \$	Total cost \$	Qty	Unit cost \$	Total cost \$
2026										
July 1	Balance							80	10.00000	800.00
6	Purchase	250	11	2 750				330	10.75758	3 550.00
8	Issue				270	10.75758	2 904.55	60	10.75758	645.45
13	Issue				40	10.75758	430.30	20	10.75758	215.15
15	Purchase	100	13	1 300				120	12.62625	1 515.15
24	Purchase	170	14	2 380				290	13.43155	3 895.15
26	Issue				140	13.43155	1 880.42	150	13.43155	2 014.73

Figure 5.11 A stock item record using weighted average cost (with calculations below)

Working of weighted average unit cost

a	80 @ \$10	800	b	20 @ \$10.75758	215.15	c	120 @ \$12.62625	1515.15
	<u>250 @ \$11</u>	<u>2750</u>		<u>100 @ \$13</u>	<u>1300.00</u>		<u>170 @ \$14</u>	<u>2380.00</u>
	330	\$3550		120	1515.15		290	3895.15
	$\frac{3550}{330} = \$10.75758$			$\frac{1515.15}{120} = \$12.62625$			$\frac{3895.15}{290} = \$13.43155$	

A new weighted average is calculated after each purchase. Total costs in the Out and Balance columns are rounded to the nearest cent.

The weighted average cost method derives its name from the fact that the unit cost is weighted by the quantity. Particular attention should be paid to how the weighted average is calculated. The weighted average should always be calculated to at least five decimal places. This will minimise rounding errors.

The following inventory costs are extracted from the stock item in Figure 5.11:

Product X	Cost price from weighted average stock item record	
	\$	\$
Sales July 8	2 904.55	
Sales July 13	430.30	
Sales July 26	<u>1 880.42</u>	
Cost of goods sold		5 215.27
Inventories on Hand		2 014.73

Using the weighted average method in Figure 5.11 and the information above, the cost price for the goods sold on 8 July is \$2 904.55, on 13 July is \$430.30 and on 26 July is \$1880.42. The stock item record determines the cost price for each sale that takes place.

For cost of goods sold, as there are no returns, these cost prices are obtained from the total cost in the Out column. All the amounts have 'issue' beside them.

In all previous exercises, for each sale, the cost price was given to you. In practice, the computer calculates the cost price and uses that in the accounting entry to affect the Cost of Goods Sold account and the Inventories account for the cost price of the goods sold.

Check for understanding

- 5.20 a **Explain** the purpose of a stock item record.
 b What information is recorded?
- 5.21 a Name and briefly describe three different methods of determining the cost price of inventories.
 b Name a type of inventory suitable for each method.
- 5.22 At 1 October, the balance of a certain item of inventory was 600 units at \$3 per unit. During the month, the following movements in inventories were recorded:

Oct	3	Purchased	200 units @ \$3.20 per unit.
	6	Sold	400 units.
	10	Sold	250 units.
	16	Purchased	500 units @ \$3.10 per unit.
	18	Sold	600 units.

Prepare a stock item record using weighted average. **Calculate** the cost of goods sold for that particular item using this method.

- 5.23 Refer to the stock item record for product Y on the next page.
- What inventory system is being used?
 - What costing method is being used?
 - What is the quantity and value of inventories on hand?
 - For this particular item, what is the cost of goods sold? How is this determined?

Stock Item Product Y										
Date	Particulars	In			Out			Balance		
		Qty	Unit cost \$	Total cost \$	Qty	Unit cost \$	Total cost \$	Qty	Unit cost \$	Total cost \$
Sep 1	Balance							70	3.00000	210.00
10	Purchase	25	3.40	85				95	3.10526	295.00
16	Issue				40	3.10526	124.21	55	3.10526	170.79
21	Purchase	90	3.20	288				145	3.16407	458.79
24	Purchase	100	3.60	360				245	3.34200	818.79
26	Issue				160	3.34200	534.72	85	3.34200	284.07

Accounting records under the perpetual inventory system using an inventory subsidiary ledger

The main features of a perpetual inventory system are:

Stock item records (subsidiary ledger) The stock item records constitute a subsidiary ledger (similar to an Accounts Receivable or Accounts Payable ledger). This subsidiary ledger shows all the detailed cost information about the movements of each stock/inventory item in and out of the business at cost price.

Control account in general ledger A control account called Inventories Control (or Merchandise Control) records these same movements in and out of the business in the general ledger.

Cost of Goods Sold account in general ledger This account keeps a continuous record of all costs associated with the inventories sold. It is therefore an expense account.

As discussed, whenever there is a sale or sales return, the transaction has two elements:

- a selling price
- a cost price (**obtainable from the stock item record**).

Both these prices must be entered in the records.

Inventory adjustment account in general ledger

As already explained, the stock item record shows the value of inventory that should be on hand. This system therefore gives better control because inventory losses are readily determined. At any point in time, the number of items can be physically counted to determine the actual quantity on hand. If there are any differences, then inventory losses and shortages can be brought into the accounts. In a large warehouse, this checking is done on a continuous basis.

It is also usual to conduct a yearly stocktake. Stocktaking is the process of listing, counting and valuing unsold inventories on hand. (It will be discussed further in Chapter 7.) If the continuous checking or stocktake reveals fewer items in stock than are shown on the stock item record, the record is adjusted to show the actual quantity on hand. The general journal entry to record the value of the inventory shortage is:

Inventory Adjustment	Dr	XXX
Inventories Control	Cr	XXX
(Shortage on stock item no xx)		

This has the effect of:

- decreasing the gross profit figure, as the Inventory Adjustment is an expense to the business
- decreasing the Inventories Control account and the stock items, as the inventories are no longer on hand.

The advantage of the perpetual inventory system is that it makes management aware of any inventory shortage. If the inventory shortages continue or become a large figure, investigations into the cause must be undertaken.

Illustrative example 4: Stock item record, ledger and inventory shortage using weighted average

On 1 October, 50 units of item P were on hand at a value of \$250. This was the only inventory sold in the business, the item was GST-free and a perpetual inventory system (using weighted average) was used. The following transactions occurred:

Purchases	
Oct 1	600 units @ \$6 per unit.
7	500 units @ \$5 per unit.
Sales	
Oct 4	400 units for \$4000.
15	550 units for \$5000.
Purchases returns	
Oct 10	20 units @ \$5 per unit.
Sales returns	
Oct 12	50 units for \$450 (originally sold on 4 Oct).
Additional information	
Oct 21	paid \$400 for customs duty.
Oct 31	stock check revealed that there were 200 units on hand.

Assume that all sales returns are returns that have been made by the customer and that the goods are in a condition for resale. This assumption is used throughout this chapter.

The stock item record resulting from these transactions is shown below:

Stock Item										
Description <u>Item P</u>					Stock no					
Maximum quantity					Reorder point					
Minimum quantity					Reorder quantity					
Date	Particulars	In			Out			Balance		
2026		Qty	Unit cost \$	Total cost \$	Qty	Unit cost \$	Total cost \$	Qty	Unit cost \$	Total cost \$
Oct 1	Balance							50	5.00000	250.00
	Purchases	600	6.00000	3 600.00				650	5.92308	3 850.00
4	Issue				400	5.92308	2 369.23	250	5.92308	1 480.77
7	Purchases	500	5.00000	2 500.00				750	5.30769	3 980.77
10	Purchases returns				20	5.00000	100.00	730	5.31612	3 880.77
12	Issue returns	50	5.31612	265.80				780	5.31612	4 146.57
15	Issue				550	5.31612	2 923.87	230	5.31612	1 222.70
31	Inventory shortage				30	5.31612	159.48	200	5.31612	1 063.22

Working of weighted average unit cost

New calculations are performed after a purchase or purchases return:

a	50 @ \$5.00	250.00	c	750 @ \$5.30769	3980.77
	<u>600 @ \$6.00</u>	<u>3600.00</u>		<u>-20 @ \$5.00</u>	<u>-100.00</u>
	650	3850.00		730	3880.77
	$\frac{\$3850.00}{650} = \5.92308			$\frac{\$3880.77}{730} = \5.31612	

b	250 @ \$5.92308	1480.77
	<u>500 @ \$5.00</u>	<u>2500.00</u>
	750	3980.77
	$\frac{\$3980.77}{750} = \5.30769	

For the issue return, the figure used for the unit cost of the return is simply the balance unit cost. This is because all the costs are averaged out under the weighted average method. Weighted average cost (as its name suggests) is an amalgamation of cost prices. Therefore, **new unit costs are generally only calculated when there is a purchase or purchases return** (and therefore a change in cost price). This is what makes the weighted average cost method the most convenient to use in computer systems.

The adjustment for the inventory shortage is made first in the stock item record. Having made this adjustment, the resultant journal entry to the general ledger can be processed.

The general ledger showing these transactions would appear as follows:

General Ledger				
Date	Particulars	Dr	Cr	Balance
		\$	\$	\$
Sales				No 1101
Oct 4	Cash/Accounts Receivable		4 000.00	4 000.00 Cr
15	Cash/Accounts Receivable		5 000.00	9 000.00 Cr
Sales Returns				No 1101A
Oct 12	Accounts Receivable	450.00		450 Dr
Cost of Goods Sold				No 2105
Oct 4	Inventories Control	2 369.23		2 369.23 Dr
10	Inventories Control	2 923.87		5 293.10 Dr
12	Inventories Control		265.80	5 027.30 Dr
15	Cash (customs duty)	400.00		5 427.30 Dr
Inventory Adjustment				No 2106
Oct 31	Inventories Control	159.48		159.48 Dr
Inventories				No 3106
Oct 1	Balance			250.00 Dr
1	Cash/Accounts Payable	3 600.00		3 850.00 Dr
4	Cost of Goods Sold		2 369.23	1 480.77 Dr
7	Cash/Accounts Payable	2 500.00		3 980.77 Dr
10	Accounts Payable (purchase return)		100.00	3 880.77 Dr
12	Cost of Goods Sold (return)	265.80		4 146.57 Dr
15	Cost of Goods Sold		2 923.87	1 222.70 Dr
31	Inventory Adjustment		159.48	1 063.22 Dr

From the general ledger above, you will notice that with the exception of the customs duty and the inventory adjustment, this is no different from what has previously been done throughout this book. The only difference is that the cost prices for each sale or sale return in the Inventories and Cost of Goods Sold accounts must be obtained from the stock item record.

Also notice that the debit side of the Inventories Control account coincides with the In column of the stock item record and the credit side coincides with the Out column. This is the effect of the subsidiary ledger–control account technique.

If you want to determine the cost of goods sold for a particular item, it can be obtained from the stock item record. However, when determining the cost of all goods sold and gross profit for the whole firm, the balance of the Cost of Goods Sold account is used. This is because there are stock item records for every inventory item in the business, and it would be impracticable to search through each one looking for the cost of goods sold amount.

Sometimes, these Cost of Goods Sold expenses – such as Agent expenses, Cartage on purchases/Freight inwards, Customs duty and Packaging expenses – are shown in separate ledger accounts; for example, account numbers 2101 to 2104 in the Chart of Accounts on page 349. If this is done, then they may be shown separately under the Cost of Goods Sold section of the Statement of Profit or Loss. Alternatively, every month, the balances of these accounts can be transferred to the Cost of Goods Sold account.

A further reason for using the ledger account is that the stock item records do not show expenses incurred in getting the goods to their present location and into condition ready for sale (cartage inward, customs duty and so on). These expenses are also part of the cost of goods sold.

The following is a summary of the major transactions that affect the Inventories Control account and Cost of Goods Sold account under the perpetual inventory system:

Transaction	Effect on:	
	Inventories Control (cost price)	Cost of Goods Sold (cost price)
Sale of inventories	Credit	Debit
Sales returns of inventories	Debit	Credit
Purchase of inventories	Debit	–
Purchases returns of inventories	Credit	–
Cost of goods sold expenses (cartage inwards, customs duty)	–	Debit
Inventory adjustment (loss)	Credit	–

Finally, because monthly financial statements can be prepared for this trading business, the reports would appear as follows:

Statement of Profit or Loss (Extract) for month ended 31 October		
	\$	\$
Sales	9 000.00	
<i>Less Sales Returns and Allowances</i>	<u>450.00</u>	8 550.00
Less Cost of Goods Sold	5 427.30	
Inventory Adjustment	<u>159.48</u>	<u>5 586.78</u>
Gross profit		2 963.22

This statement is slightly different from the one prepared for a service business. This is because a trading business wants to know how much profit it is making purely from the purchase and sale of inventories. This results in a gross profit figure.

All the other revenue and expense items would be added to the bottom of this statement to obtain the net profit.

Statement of Financial Position (Extract) as at 31 October		
	\$	\$
Assets		
Inventories		1 063.22

Check for understanding

- 5.24 State the content and purpose of an Inventory Control account.
- 5.25 a **Explain** why the cost of goods sold for a firm should be obtained from a Cost of Goods Sold account and not from individual stock item records.
- b State the content and purpose of the Cost of Goods Sold account.
- 5.26 Why is a physical check or stocktake still necessary under the perpetual inventory system?
- 5.27 On 1 July, Wilson Trading had 100 units of a particular item on hand at a value of 80c per unit. The following transactions occurred:

July	2	Purchased	90 units @ 85c per unit.
	6	Sold	110 units @ \$1.50 per unit.
	10	Sold	60 units @ \$1.45 per unit.
	12	Purchased	80 units @ 95c per unit.
	14	Sold	70 units @ \$2 per unit.
	31	Physical check revealed only 27 units on hand.	

On the basis of this information, **prepare** the:

- a stock item record using the weighted average method
- b Inventories Control, Cost of Goods Sold, Inventory Adjustment and Sales accounts.

Advantages of the perpetual inventory system

The perpetual inventory system has the following advantages:

- There is great control over inventories because the business knows what items **should** be on hand. These are compared with what items **actually** are on hand when the stock check or stocktake is performed. Shortages and losses can therefore be isolated.
- Short-term financial statements can be prepared as the values of cost of goods sold and inventories on hand are available in the ledger.
- The stock item records in a computer system help to maintain sufficient quantities of inventories for sale, ensuring that the business is rarely out of items or has too much money tied up in inventories.

Real-world application



Supermarkets increasing spend on security and technology to stop thieves

Nassim Khadem

Wesfarmers director Rob Scott told ABC's The Business program stock loss was an issue they were managing.

The operator of Kmart, Target, Officeworks and Bunnings on Friday posted an 18.2 per cent jump in revenues for the year to \$43.6 billion.

Profits for the period were up 4.8 per cent to \$2.47 billion, with Kmart and Officeworks delivering some of the group's highest returns for the year.

'We've seen an increase in stock loss over the last 12 months in our retail businesses, but it's been fairly modest and it's largely been a reversion back to levels experienced pre COVID,' Mr Scott said.

To stop the thieves, Coles is spending big on trolley locks and smart gates that can tell if someone is leaving the store without paying.

‘What we’re really focused on now is putting in place a number of initiatives which will help us to address the issue, including security solutions in the store, like having a security guard there, but also some technology solutions,’ [Coles CEO Leah Weckert] says.

Woolworths, which recorded a 4.6 per cent rise in full-year profit to \$1.62 billion, is also increasing its spend on security and technology to fight the problem.

Thanks to higher prices for groceries, it saw a big lift in its food margin – up by 76 basis points to 28.1 per cent.

Its chief executive Brad Banducci this week wouldn’t specify how much theft has wiped off their bottom line, but noted that it is happening among ‘a very small subset of customers in our stores, and loss, or theft has gone up’.

He says people are stealing items that are easy to resell – ‘whether it’s razor blades, beard trimmers, electric toothbrushes, those kinds of things’.

‘And we’ve seen a number of customers be aggressive to our team,’ Mr Banducci says.

Woolworths has spent \$50 million on assisted scanners when people use self-service check-outs. But there’s a number of other measures being rolled out across the business.

‘When you come into a store, you come through a welcome gate to what is now called a double welcome gate – that’s two gates ... to prevent someone just pushing a trolley out through the front of the store,’ he says, noting these double gates are now in virtually every store in their network.

He says there’s now also systems in over 500 stores that ensure someone using a self-service check-out correctly scans a product before they leave the store.

Extract from article *Supermarkets increasing spend on security and technology to stop thieves* by Nassim Khadem. Posted Sat 26 Aug 2023 at 5:20am, updated Sun 27 Aug 2023 at 3:14pm on ANC News website. Source : <https://www.abc.net.au/news/2023-08-26/supermarkets-shoplifters-theft-crime-groceries-coles-woolworths/102772936>

Check for understanding

5.28 **Explain** why the perpetual inventory system is used by most businesses that have inventories.

MYOB AccountRight accounting package for a trading business with GST using subsidiary ledgers

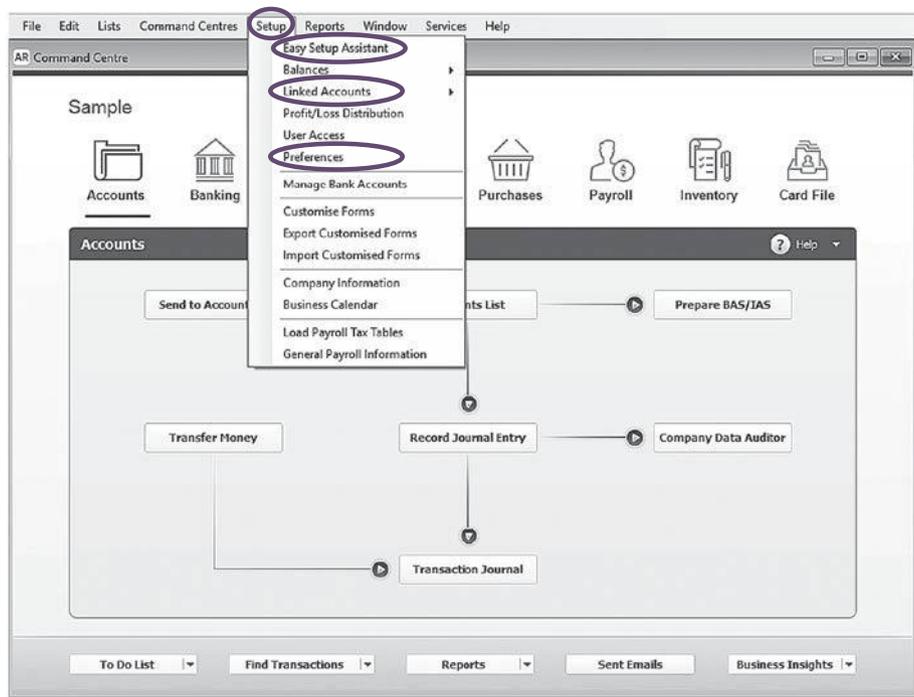
In Chapter 4, you were shown how to use MYOB to record transactions for a service business with no GST and using only the general journal. The use of the general journal was to emphasise the conceptual nature of accounting and to ensure that you understood and could apply the double-entry accounting system. In the real world, processing thousands of very similar transactions day after day means that ease of processing these transactions becomes vital to the survival of the business.

As a result, very few businesses would enter every transaction through the general journal as you did in Chapter 4. As well, most businesses have to account for the GST. Accounting packages make this very easy. This section illustrates how a trading business records transactions with GST using the various menu options in the package. The menu options allow for faster data entry but will still end up with the same general journal entry. The results are the same except it is done much more efficiently.

MYOB AccountRight is the accounting package that will be used in this illustration. However packages such as Reckon and Xero are very similar. If you use one of these other packages, the processes are the same but there will be different menu options.

Setting up

- Step 1** On page 164, you were shown how to set up a file for a new service business. This time we will set up the new file for a trading business. The same process will be used by clicking on the **Create** button and completing the information for the MYOB product name, company information and financial year, using a MYOB sample list of accounts for a **retail or wholesale business**, the name of the file and where the file will be saved.
- Step 2** Because the GST will be implemented and separate ledgers for accounts receivables, accounts payables and inventories are going to be used, some extra setup information will need to be entered. The good thing about this is that although it takes some time to do, once it is done, it never has to be touched again unless there is a change in circumstances. The setting up for these elements is done through **Setup** in the main menu, as shown in Figure 5.12.



Source: MYOB

Figure 5.12 Setup option

The first option to look at is the **Preferences** option in **Setup**. Click on each of the options for System, Windows, Reports & Forms, Banking, Sales, Purchases, Inventory Security and Emailing, and see what the default selections are.

- Step 3** So that the correct amount of GST is charged and collected, various GST codes are used; therefore the calculation of GST is automatic. To see the GST codes previously set up, click on **Lists, Tax Codes**. The most common tax codes used will be GST (non-capital items that attract normal 10% GST), FRE (0% as this is GST-free), CAP (for capital acquisitions such as office equipment and motor vehicles attracting 10% GST) and N-T (not reportable and so 0% GST). These codes are generally attached to every account so that whenever the account is affected, the GST is automatically calculated. You can see the default tax codes by clicking on **Lists, Accounts**. If any of the tax codes are incorrect, the account can be edited and the code changed.
- Step 4** Now that the underlying options for the accounting package and the GST codes have been set up, choices must be made about how to account for accounts receivable, accounts payable and inventories. For accounts receivable and accounts payable, the easiest way to set these up is through **Setup** and

then **Easy Setup Assistant**, as shown in Figure 5.12. When you click on this option, the screen in Figure 5.13 will appear.

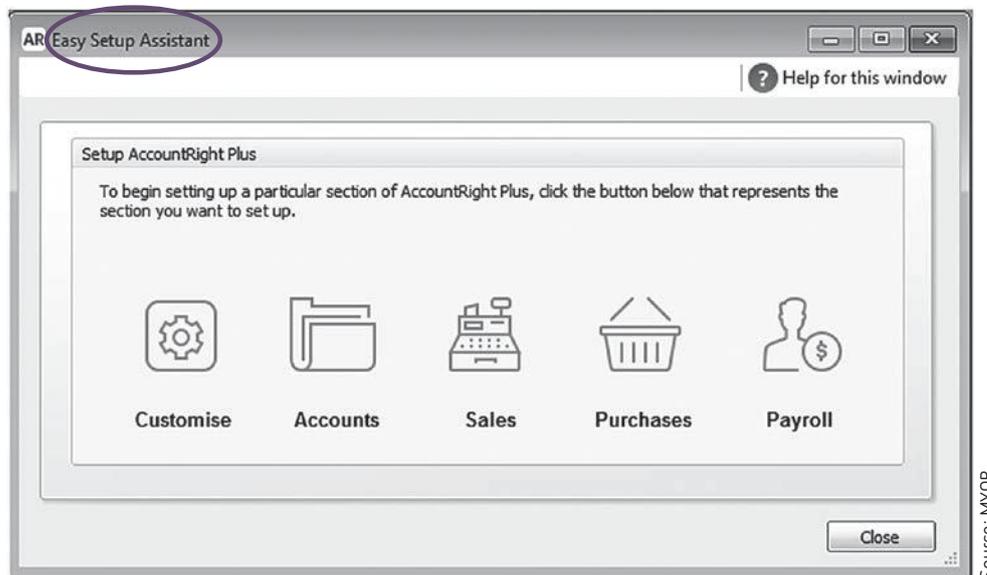


Figure 5.13 Easy Setup Assistant

Looking at Figure 5.13:

- In **Customise**, pay particular attention to Data Entry and Record Selection.
- In **Accounts**, as shown in Figure 5.14 for Accounts List, you will have to edit account number 4-2000 to change the name to Sales. You will also create an account number 5-1000 for Cost of Goods Sold. Any new accounts or changes to the names of accounts can be done here or through **Lists, Accounts** in the top menu.

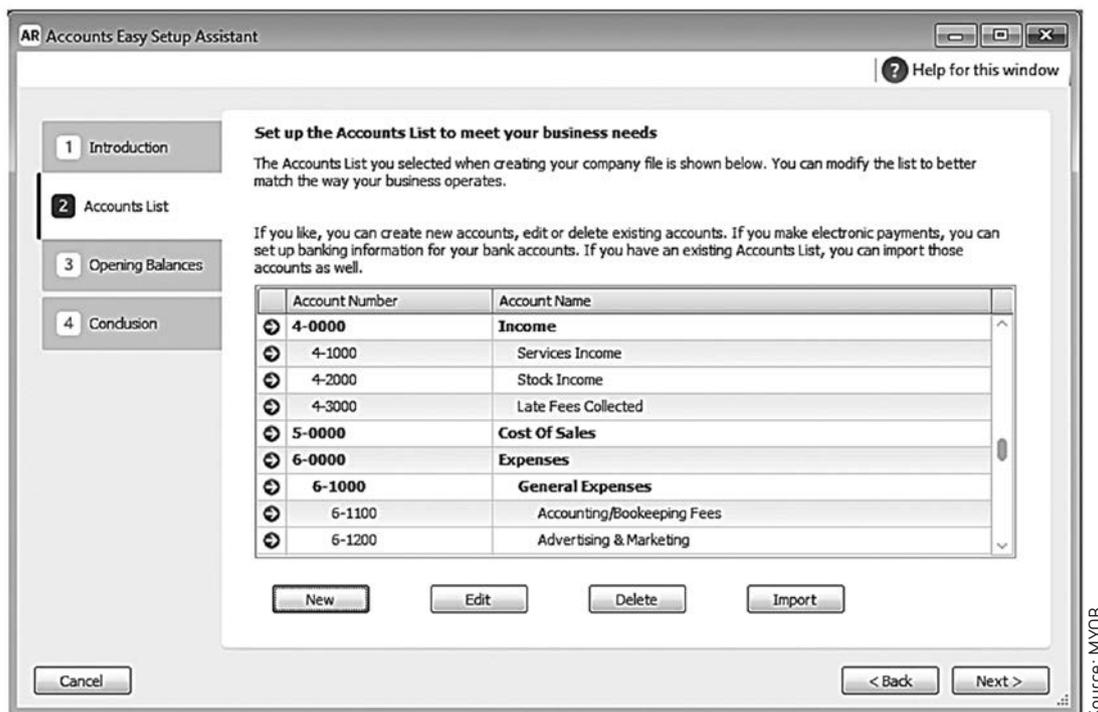


Figure 5.14 Easy Setup Assistant for Accounts, Accounts List

It is vital to emphasise again that the chart of accounts is the whole basis for entry into the general ledger. It is most important that these accounts and account numbers are correct as they are also the basis of all reports coming from the system. Ensuring these accounts are correct can be time consuming but is absolutely essential.

- In **Sales** in Easy Setup Assistant (see Figure 5.13), the following should be chosen:
 - 1 Layout: click on Item Layout for invoices so that the perpetual inventory system will be used. This will keep track of all inventories sold.
 - 2 Selling Details: for Item Price Level the base selling price is correct; for the Income Account, leave this blank as there can be many forms of income; and make the Credit Limit \$50 000 so you can enter most transactions. In reality, this credit limit would be set at the proper limit.
 - 3 Tax Codes: the GST code should be chosen.
 - 4 Linked Accounts: check that the correct accounts have been chosen for Account for Customer Receipts and Account for Undeposited Funds.
 - In **Purchases** in Easy Setup Assistant (see Figure 5.13), the following should be chosen:
 - 1 Layout: click on Item Layout for invoices so the perpetual inventory system will be used. This will keep track of all inventories purchased.
 - 2 Buying Details: for the Expense Account, leave this blank as there can be many expenses used; and make the Credit Limit \$50 000 so that you can enter most transactions. In reality, this credit limit would be set at the proper limit.
 - 3 Tax Codes: the GST code should be chosen.
 - 4 Linked Accounts: check the correct account has been chosen for Account for Paying Bills.
- Finally, click on **Lists, Accounts** and do a final check that all accounts and the tax codes applicable to those accounts are correct.

- Step 5** In order that the various menu options for processing transactions actually post amounts to the correct accounts, it is important that the accounting system knows the accounts to use. As shown in Figure 5.12, in **Setup, Linked Accounts**, check each of Accounts & Banking Balance, Sales Accounts and Purchase Accounts to confirm that the accounts are correct.
- Step 6** Create Customer Cards for each customer. This records details relating to each customer such as name, address and so on. This can be done in advance through **Lists, Cards, Customer**, and **New**; or it can be created at the time of the transaction.
- Step 7** Create Supplier Cards for each supplier. This records details relating to each supplier such as name, address and so on. This can be done in advance through **Lists, Cards, Supplier**, and **New**; or it can be created at the time of the transaction. Because suppliers are often paid large amounts of money, it is vital that the information is correct. Often only senior people are allowed to create new suppliers on the system. This is to avoid employees setting up fictitious suppliers and then paying fictitious invoices from these suppliers.
- Step 8** Create Items to buy and sell in order to make a profit. Because the perpetual inventory system is being used and the weighted average inventory costing method applied, the accounts to record these inventory movements must be detailed. Click on **Lists, Items, New**, and a typical product to be bought and sold would appear as shown in Figure 5.15. As well as setting up in Profile the accounts down the bottom for recoding cost of goods sold, sales and inventories, in Buying Details the appropriate GST code would be entered (e.g. GST or FRE), and in Selling Details the Base Selling Price for the product and the appropriate GST code (e.g. GST or FRE) would be entered. Every product bought and sold would require a separate and unique Item number, so this process is quite tedious to set up. However, once it is done, most elements rarely change except perhaps the selling price.

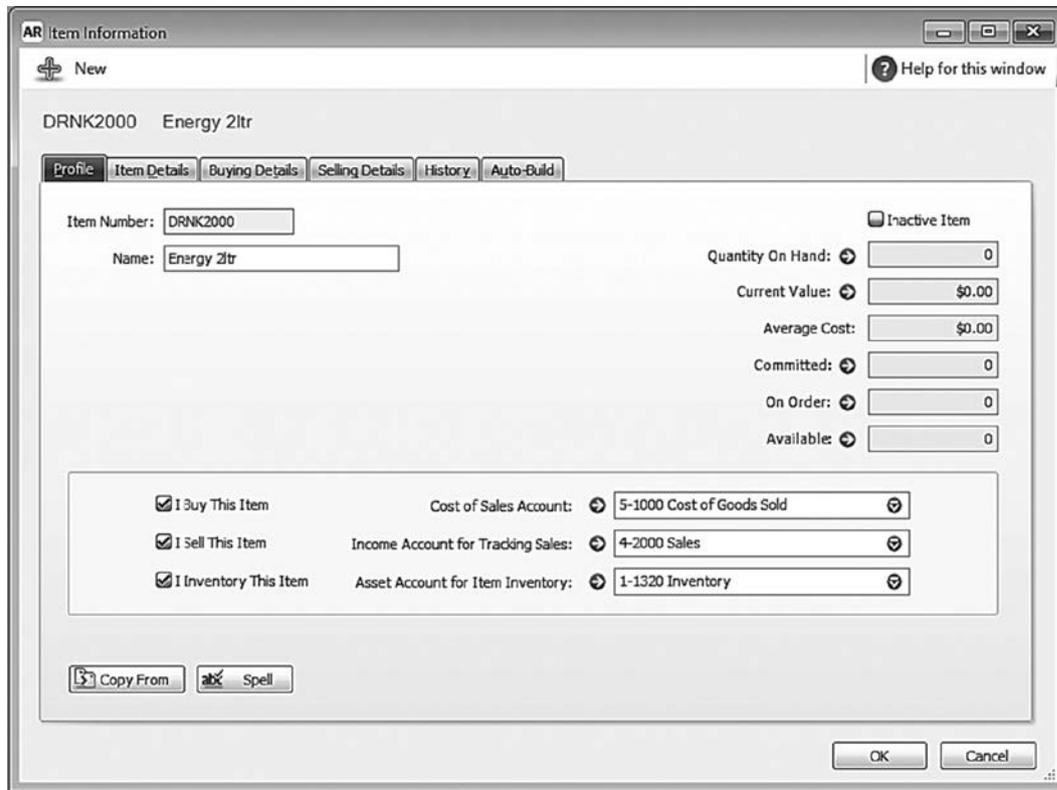


Figure 5.15 Item product screen

Entering transactions through the menu options

The initial setting up can be a lengthy process. However, once it is done correctly, it will only change if circumstances change. The most common transactions will now be entered through the various Command Centres.

Banking command centre

The banking command centre is shown in Figure 5.16. The important thing about this option is the computer knows that all these cash receipts and payments affect the Bank account. So when you enter the data, the computer only wants to know the details relating to the other side of the transaction. Looking at Figure 5.16, there are two key options:

- **Receive Money** This is used for all receipts of money from organisations that are not set up as accounts receivable. For example, if \$25 is received as interest, the computer knows that the money will be debited to the Bank account. When you complete the screen, you will be telling the computer the details of the credit entry that relates to interest revenue. If money is received from an Accounts Receivable, it is NOT recorded here.
- **Spend Money** This is used for all payments of money to organisations that are not set up as accounts payable. For example, if you pay \$1200 in rates to the council, the computer knows that the money will be credited to the Bank account. When you complete the screen, you will be telling the computer the details of the debit entry that relates to rates. If money is paid to an accounts payable, it is NOT recorded here.

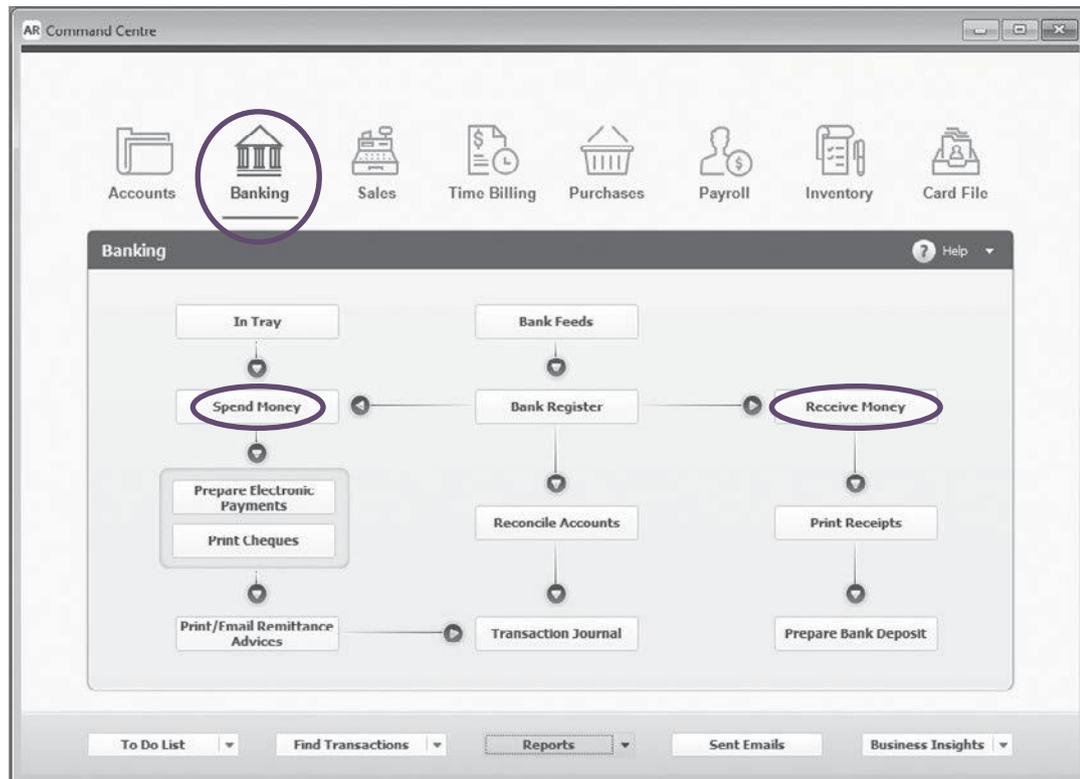


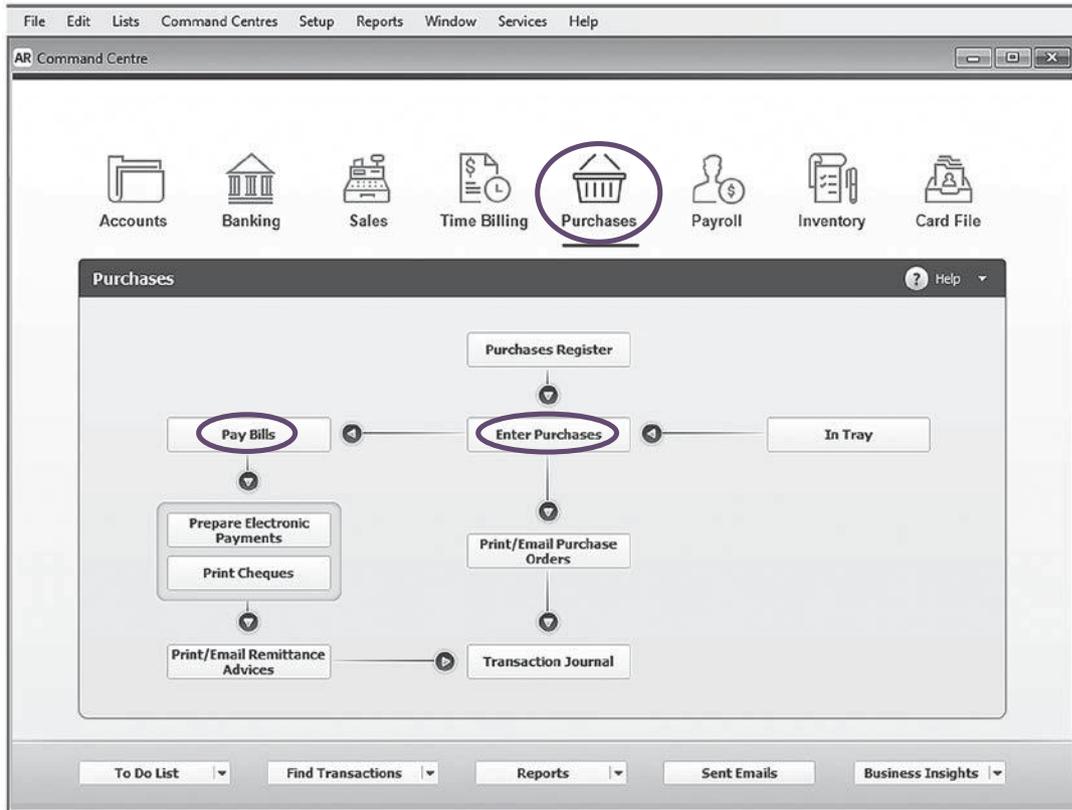
Figure 5.16 Banking command centre

Purchases command centre

It is important to understand that because subsidiary ledgers are used for accounts payable, all transactions have to be entered into the individual accounts payable accounts and the control account in the general ledger will be automatically updated. Also, because the Item layout is being used for tax invoices, each individual inventory item must be recorded as purchased and this will automatically update the inventories (control) account in the general ledger.

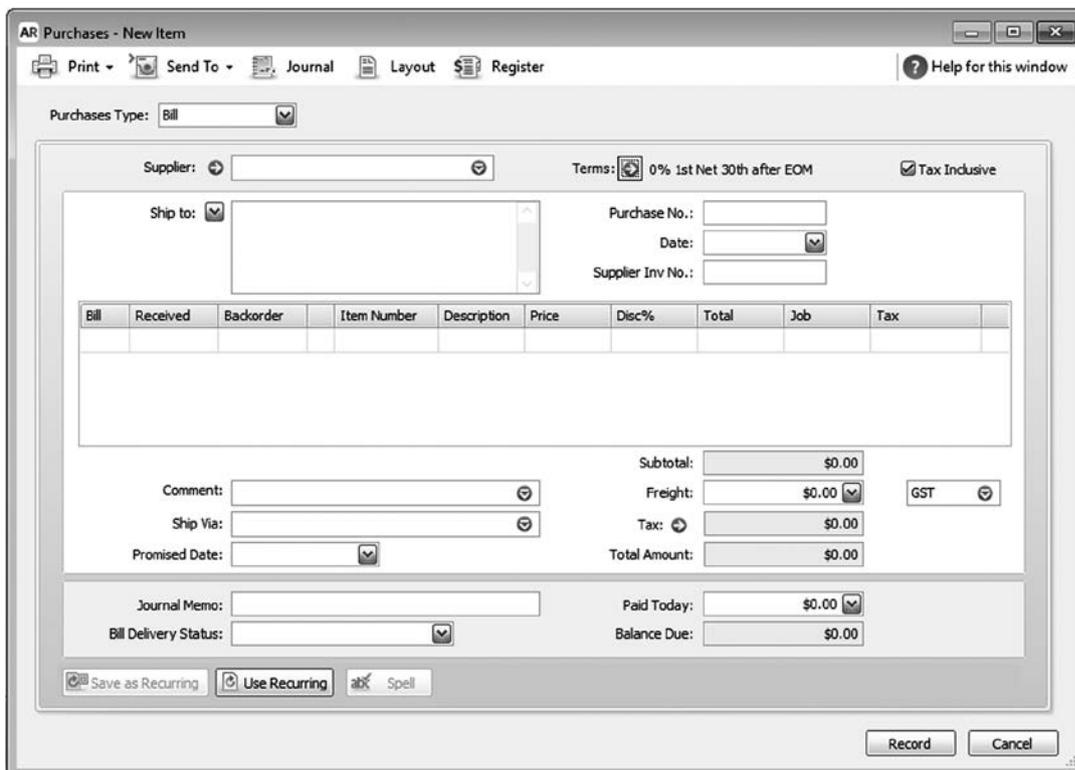
Therefore, if a transaction involves an accounts payable, the Purchases command centre as shown in Figure 5.17 must be used. There are two main options:

- **Enter Purchases.** As shown in Figure 5.18, a representation of a tax invoice will appear and the details relating to the supplier and each item purchased including quantity, item number and cost will be entered. If this is a cash purchase, then an accounts payable called Cash Purchases will be created, the inventory items recorded and the cash paid immediately. As a result, there should never be a balance in the Cash Purchases subsidiary ledger account. Regardless of whether it is a cash or credit purchase, to record the purchase of individual inventories, this Enter Purchases option must be used. If the transaction involves a purchase return, it is exactly the same as a purchase except that negative quantities (e.g. -3) are recorded for the quantities being returned.
- **Pay Bills.** This option is used to pay bills created under Enter Purchases for all accounts payable.



Source: MYOB

Figure 5.17 Purchases command centre



Source: MYOB

Figure 5.18 Enter purchases

Sales command centre

Once again, because subsidiary ledgers are used for accounts receivable, all transactions have to be entered into the individual accounts receivable accounts and the control account in the general ledger will be automatically updated. Also, because the Item layout is being used for tax invoices, each individual inventory item must be recorded as sold and this will automatically update the inventories (control) account in the general ledger.

Therefore, if a transaction involves an accounts receivable, the Sales command centre as shown in Figure 5.19 must be used. There are two main options:

- **Enter Sales.** Similar to Figure 5.18, a representation of a tax invoice will appear and the details relating to the customer and each item sold, including quantity, item number and selling price, will be entered. The weighted average cost method will be used to calculate the cost price of each item sold and will automatically be recorded. If this is a cash sale, then an accounts receivable called Cash Sales will be created, the inventory items recorded and the cash received immediately. As a result, there should never be a balance in the Cash Sales subsidiary ledger account. Regardless of whether it is a cash or credit sale, to record the sale of individual inventories, this Enter Sales option must be used. If the transaction involves a sales return, it is exactly the same as a sale except that negative quantities (e.g. -2) are recorded for the quantities being returned.
- **Receive Payments.** This option is used to receive money created under Enter Sales for all accounts receivable.

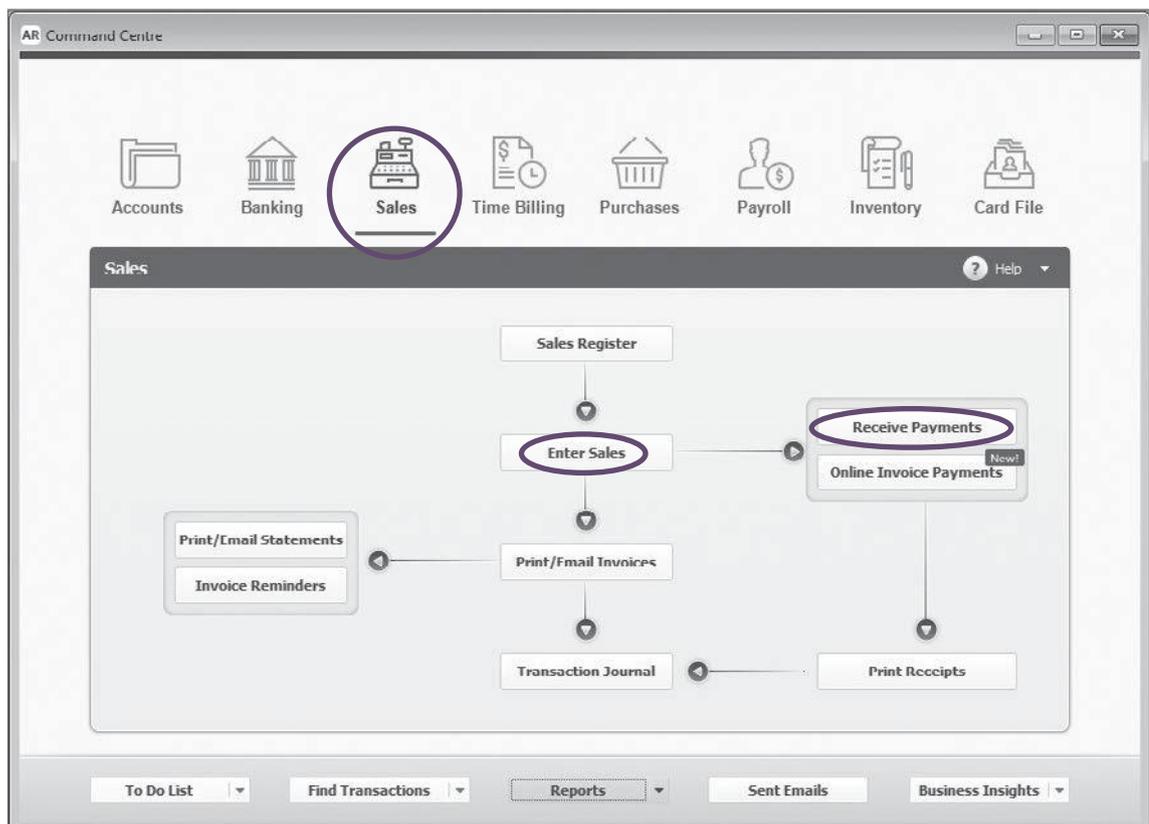
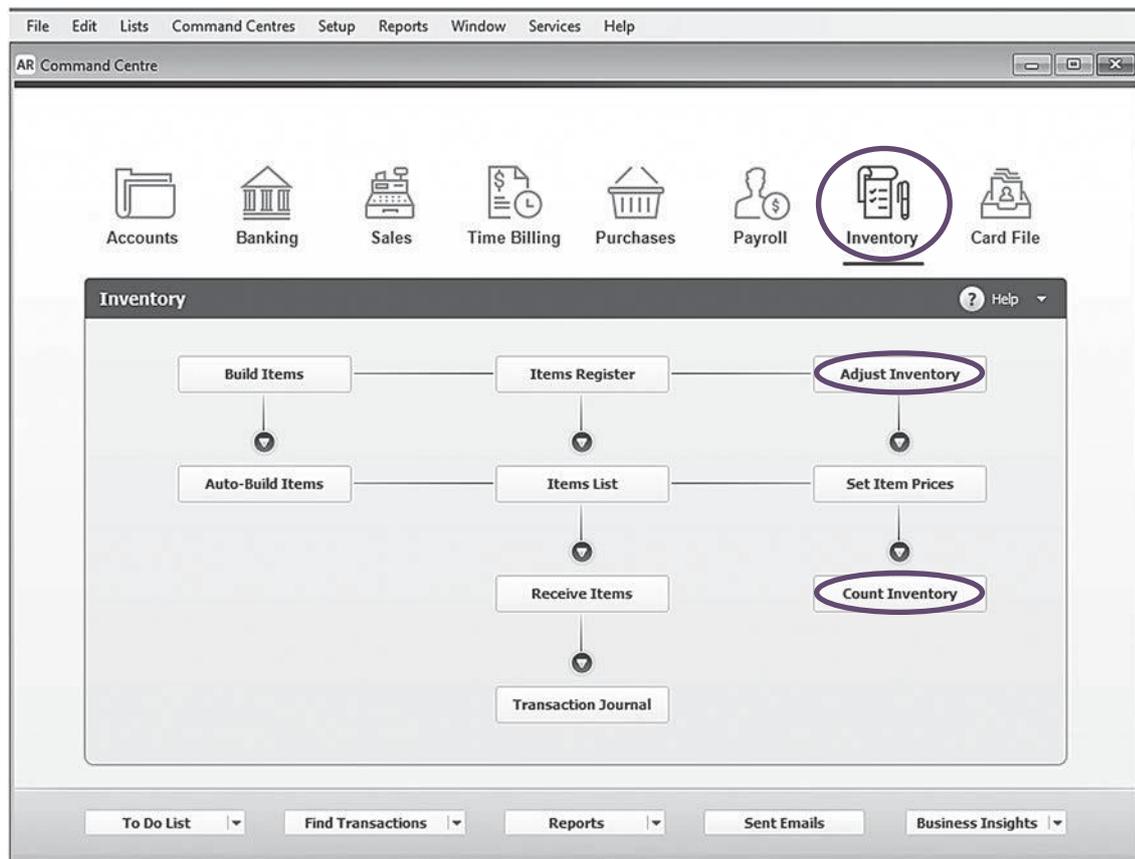


Figure 5.19 Sales command centre

Inventories command centre

Previously in this chapter, it was explained that the perpetual inventory system is used in computer packages because of the greater control over inventories. One of the advantages is that, at any time, the computer records can show what quantities of any stock item should be on hand and someone can then go and check if that quantity actually is on hand. If there is a discrepancy, it is recorded in the **Inventories** command centre as shown in Figure 5.20. This can be done through **Adjust Inventory** or **Count Inventory**, and any appropriate stock loss can be brought to account.



Source: MYOB

Figure 5.20 Inventories command centre

Tips

- Make sure you enter the correct date for each entry, **especially the correct year**. If you don't, the transaction will be recorded correctly but will not appear as expected in the reports.
- If you want to see the debit and credit effect of each transaction before you click on the Record button and post to the ledger, use Edit, Recap Transaction or CTRL R. If you have already recorded and posted the entries, click on Transaction Journal at the bottom of each Command Centre screen to see the effect of each data entry. It is important that you use the correct dates for From: and To: in the Transaction Journal.

Accounts command centre

As discussed previously, general journal entries are entered through Accounts, Record Journal Entry. Only transactions that cannot be entered through the other Command Centres will be entered via a general journal. These are typically balance day adjustment entries (see Chapter 6).

Reports

The great thing about an accounting package is that reports can be prepared at any time. Reports can be found in the main menu along the top or towards the bottom of any Command Centre. Typical reports used to manage a business are listed in Table 5.2.

Table 5.2 Common MYOB AccountRight reports

Command Centre	Report
Accounts	Accounts List [Detail] General Ledger [Detail] Trial Balance Balance Sheet (Statement of Financial Position) Profit & Loss Statement (Statement of Profit or Loss) Transaction Journal
Banking	Transaction Journal
Sales	Aged Receivables [Detail] (Accounts Receivable Listing) Transaction Journal
Purchases	Aged Payables [Detail] (Accounts Payable Listing) Transaction Journal
Inventory	Item List [Summary] Item Transactions Transaction Journal

Tips

- When printing the Profit & Loss Statement and the Balance Sheet, check that the profit figure is the same in each report.
- Check subsidiary ledgers and the general ledger:
 - The total of the Aged Receivables [Detail] report should be the same as the Accounts Receivable figure in the Trial Balance/Balance Sheet.
 - The total of the Aged Payables [Detail] report should be the same as the Accounts Payable figure in the Trial Balance/Balance Sheet.
 - The total in the Items List [Summary] report should be the same as the Inventory figure in the Trial Balance/Balance Sheet.

Finally, as noted previously, at various intervals it is vital that the data file you have created is backed up to a different place from where the data are being stored, preferably at a different site. If the file gets corrupted, or if there is a fire and your computer is destroyed, you will need to obtain that backup to begin operations again. To back up your file, use the **File** option in the main menu and then **Back Up**. If something happens to your data file and you have to open a backup file, use the **File** option and then **Restore**.

Check for understanding

5.29 Using MYOB, Reckon or another accounting package, prepare a general ledger, trial balance, Statement of Profit or Loss, Statement of Financial Position and item summary for the business of Walters Hardware. Use a chart of accounts for a retail organisation. For this introductory exercise no GST is applicable, so use an appropriate tax code (NT for not taxable).

Walters Hardware uses a weighted average costing method and there is no GST. From the following information:

- a show a stock items record
- b show Sales, Sales Returns, Cost of Goods Sold, Inventory Adjustment and Inventory Control accounts
- c show financial statement extracts.

Mar	1	Commenced business with inventories on hand of 150 units of Praton A at \$2 per unit.
	2	Purchased for cash 500 units at \$3 per unit from Jackson Supplies.
	5	Sold 550 units at \$9 each to M Kantor.
	7	Sales returns from M Kantor of 25 units at \$9 each.
	10	Purchased 1000 units at \$4 per unit from Jagor Industries.
	12	Returned 20 units (purchased on 10 March) for \$80.
	20	Sold for cash 800 units at \$10 each.
	24	Sold 150 units at \$10 each to Larwon Ltd.
	27	Paid \$126 for freight inwards.
	31	Inventories on hand were 150 units.

5.30 The following is information about the business of M Smart, who runs a business called Broger Industries at 4591 Logan Road, Brisbane, Qld 4000. A perpetual inventory system is in operation and the weighted average method is used. The firm buys and sells only one health food item, called Zet. GST is applicable on all transactions and the ABN is 19 129 342 548.

Making sure you record transactions in date order and using MYOB, Reckon or a similar accounting package, show the:

- a general ledger accounts, including Sales, Sales Returns, Cost of Goods Sold, Inventory Adjustment, Inventories Control, Accounts Receivable Control and Accounts Payable Control
- b trial balance
- c Statement of Profit or Loss and Statement of Financial Position
- d Accounts Receivable listing
- e Accounts Payable listing
- f Inventory listing.

Balances at 1 June are as follows:			
Sales	\$235 400	Building	\$100 000
Cost of Goods Sold	\$180 600	Capital	\$116 200
Land	\$70 000	Inventories Control	\$1 000 (100 units)
Credit sales to Varon Ltd (inc. GST)		Sales returns from Varon Ltd	
June 2	80 units @ \$19.25	June 20	10 units (sold on 18 June)
18	800 units @ \$24.75		
27	900 units @ \$17.60		
Credit purchases from Santo Ltd (inc. GST)		Purchases returns to Santo Ltd	
June 4	800 units @ \$12.10	June 6	30 units @ \$12.10
17	1000 units @ \$13.20		
Additional information			
June 10	Paid for cartage inwards \$121 (including GST).		
30	Stocktake revealed 85 units on hand.		

Spreadsheets

Electronic spreadsheets are one of the best-selling business application packages for desktop and laptop computers. This is because they are so versatile and easy to use. VISICALC (short for Visible Calculator) was the original spreadsheet package for use on the microcomputer and was developed by Dan Bricklin and Robert Frankston in 1979. Since then, a number of packages have been released on the market – Lotus 1-2-3, SuperCalc, Quattro Pro and VP Planner are but a few of them. However, the one that is almost universally used is Microsoft Excel (MS Excel).

Four terms are commonly used in relation to spreadsheets:

- **spreadsheet** – the actual program, such as MS Excel
- **worksheet** – the building of the model (or problem-solving calculations) that is prepared using the spreadsheet program
- **workbook** – a book that contains a number of worksheets. This is useful for building large models. When data are saved, they are saved as a workbook
- **template** – an already prepared and built worksheet where the user simply enters data and obtains output. Once a worksheet is completed, it can become a template.

Spreadsheets were devised from the observation that many problems are solved with the use of a calculator, a pencil and a sheet of paper. A spreadsheet is an electronic worksheet that uses the great calculating power and memory capacity of the computer.

A spreadsheet is organised as a grid of columns and rows. Each entry position is a cell represented by a coordinate on the grid, such as A1. At each position, data can be entered in one of three forms:

- **labels** – used for descriptive text that identifies rows or columns. They are therefore generally alphabetic characters
- **numbers** – used for numeric data so that calculations can be performed
- **formulas** – used to define the relationship between numbers shown in various cells. For example, the formula =A1+A2 in cell A6 means ‘add together the numbers in cells A1 and A2 and put the answer in A6’. If we changed the numbers in A1 or A2, the answer in A6 would automatically change.

The use of formulas is the reason why the spreadsheet is so powerful. It has the ability to answer ‘what if’ questions.

Suppose we had the worksheet shown in Figure 5.21.

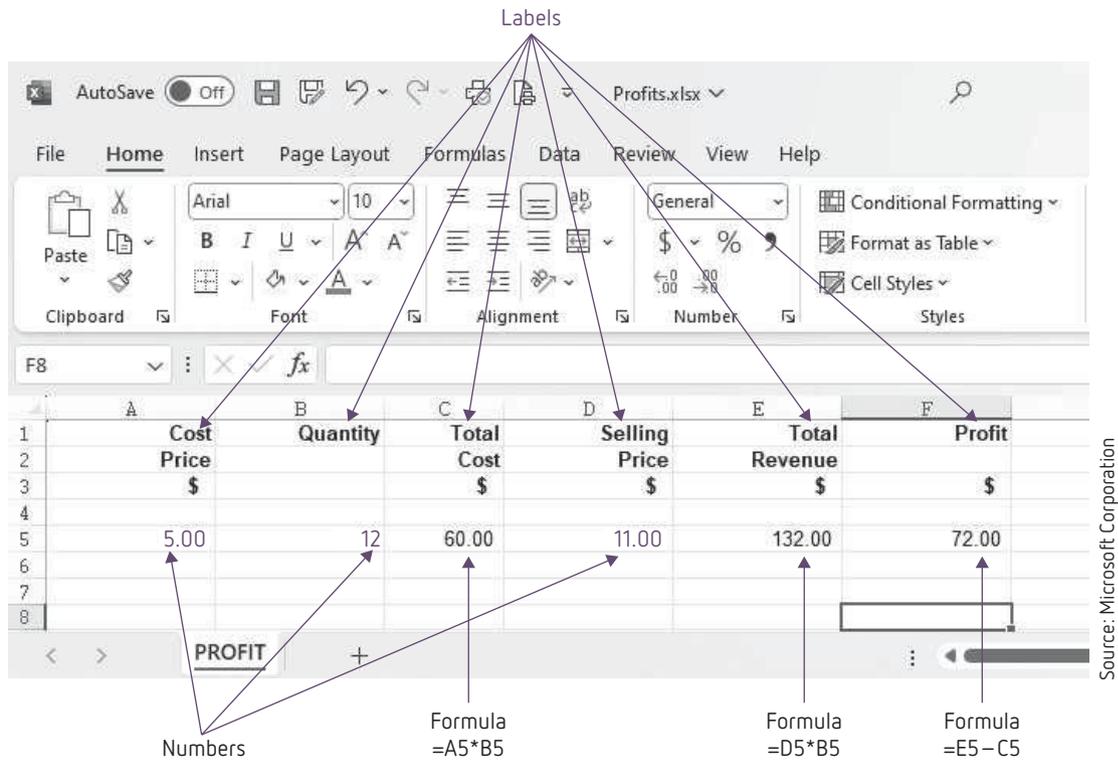


Figure 5.21 A typical spreadsheet worksheet called Profit saved in a workbook called Profits

Suppose we now said, 'What if we increase our selling price from \$11 to \$15?' All you would have to do would be to enter the number 15 into D5 and the whole worksheet would change as shown in Figure 5.22.

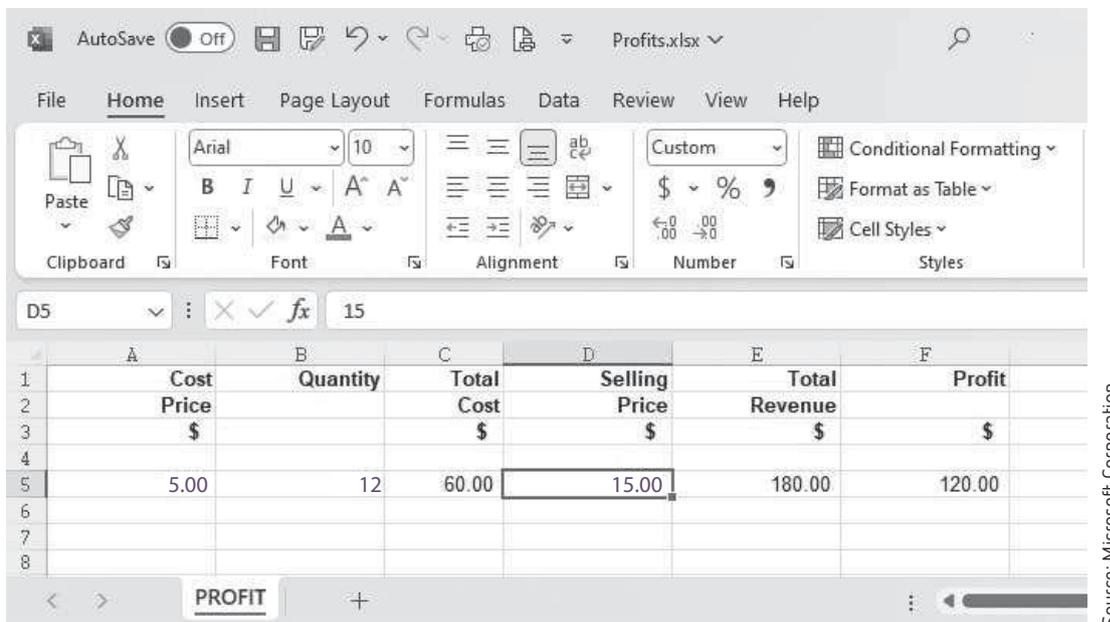


Figure 5.22 The worksheet after one item (selling price) has been changed

As you can see, a spreadsheet allows management to see the effect of policy changes immediately, rather than waiting until the task can be completed manually. Many spreadsheets are very large and could have a grid made up of hundreds of columns using uppercase letters (A, B, C and so on) and a combination of

letters (AA, AB, AC and so on), and thousands of rows. If we were to manually make a change to a pen and paper worksheet of this size, it would take a great deal of time. Using a spreadsheet, this task can be achieved in a fraction of the time.

Features of spreadsheets

Having been introduced to the basic elements of spreadsheets and how they are developed, what features are available in most spreadsheet packages? Apart from the usual features of being able to save, open and print spreadsheets, and to cut, copy, paste, insert and delete rows or columns, the general features include:

Entering data It has already been shown that data can be entered in three forms: labels, numbers and formulas. Labels are used for text, numbers are used so that calculations can be performed, and formulas enable the spreadsheet to perform calculations based on numbers shown in various coordinates.

Whenever formulas are used, two major operations can be performed:

- operations such as:
 - + addition
 - subtraction
 - * multiplication
 - / division
 - = equals
 - < less than
 - <= less than or equal to
 - > greater than
 - >= greater than or equal to
 - <> not equal to
 - ^ raises to the power
- functions, including:
 - statistical functions
 - SUM(range) calculates the sum of a range of values. For example, if the function SUM(A1:A6) was entered in coordinate A7, the computer would sum all the values in the cells from A1 to A6 and place the answer in A7
 - AVERAGE(range) calculates the average of a range of values
 - COUNT(range) counts the entry positions in a range of values
 - MIN(range) minimum number in a range of cells
 - ROUND(x,n) rounds x, which is a number or formula, to n decimal places
 - INT(x) converts the value x into an integer (whole number)
 - logical functions
 - IF(condition,x,y) This enables the computer to make a decision. The function means ‘if the condition is true, return the value shown as x, otherwise return the value as y’. For example, IF(A7<A8,A7,A10) means if A7 is less than A8, use the value in A7; otherwise if A7 is not less than A8, use the value in A10
 - financial functions
 - FV shows the future return on an investment
 - PV shows the present value of an investment
 - SLN shows depreciation using the straight-line method
 - VDB shows depreciation using the diminishing balance method
 - date functions
 - DATE(y,m,d) shows the date as expressed in year, month and day
 - NOW () shows the present time and date

Formatting This enables the user to change the appearance of the screen to take into account the many ways in which figures and labels can be displayed.

Setting the **column width** enables each column of the worksheet to be the desired width. For example, in most reports the first column is very wide (say, 20 characters) to display text. The following columns will generally be figures (say, seven digits to allow for millions of dollars). The column width can be set for whatever is necessary. If you want a column that performs some calculations but do not want these to appear on the worksheet, you can use a hidden column.

Output in each column can be **justified**. This means that whatever is in the cell can be centred, justified to the left or justified to the right. Numbers and formulas can appear in a certain **format**. These can include fixed decimal, scientific notation (exponential), dollars and cents, or whole dollars. Output can also be in a particular **font, colour** or **size**.

These different types of formatting allow great flexibility in how the worksheet appears onscreen.

Copying In order to duplicate similar contents of coordinates (especially formulas and numbers), a copy facility is generally available.

The most powerful copying feature is the process of duplicating similar formulas across rows, columns or regions. Copying of formulas can be absolute, relative or mixed.

- **Absolute** means that the formula does not change regardless of where the formula is copied to. The cell references will have a dollar sign attached to them to signify an absolute reference. For example, suppose you had a formula in D5 as $=D\$1-D\2 . If you copied this formula absolutely into coordinate E5, the operation on the right of the formula would remain fixed; that is, the formula in E5 would be $=D\$1-D\2 .
- **Relative** means that the formula changes to take into account the new row or column. For example, suppose you had a formula in D5 as $=D1-D2$. If you copied this formula relatively into the coordinate E5, the operation on the right of the formula would change to take into account the new column; that is, the formula in E5 would be $=E1-E2$.
- **Mixed** means that the formula to be copied is partly absolute and partly relative. For example, if the formula in D5 was $=D\$1$, and the formula was copied to E6, the result would be $=D\$2$ with the column fixed but the row changed. If the formula in D5 was $=D\$1$, and the formula was copied to E6, the result would be $=E\$1$ with the column changed but the row fixed.

Protecting (Locking) This enables the model builder to protect the contents of a cell so that the user cannot accidentally erase an item. Generally, all formulas are protected and almost all labels are protected. Those cells that usually remain unprotected are therefore for the entry of numbers. The user can change any of the numbers and be confident that the worksheet will function correctly.

Windows Because worksheets can be wider and longer than can fit on a screen, the user might want to keep part of the worksheet fixed while moving the other part. For example, you might want to keep all the details of text in the first column fixed but want to see the various months' figures relating to those details. If a window was not available, the text in the left column would move to the left (and off the screen) as you moved the worksheet to the left.

Windows allow the user to split the screen either vertically or horizontally so that two parts of the worksheet can be seen together. When the screen is split, the windows can be scrolled together (synchronised) or shown completely independently of one another (unsynchronised).

Macros On most spreadsheet packages, a facility exists to save a series of commands that are frequently performed, known as a macro. After these commands have been saved, calling up the macro automatically performs the required commands. Macros save time by allowing the user to call up one item rather than having to repeat a sequence of commands each time from the keyboard. For example, suppose each time you wanted to use a particular worksheet you had to enter the firm name in coordinate B62, enter the date in coordinate B65 and then go to the first number to be entered in B76. This could all be saved as a macro, and at the press of a key the series of steps would be done.

Accuracy People are often lulled into a false sense of security when they read something that has been printed by a computer. They tend to believe that because a computer has produced the output, it must be correct. When building and testing a worksheet, you should assume that everything printed is wrong and prove that it is correct, rather than assuming that it is correct.

A very important aid in ensuring accuracy is to **build cross-checks or proofs** into the worksheet to have an internal proof that figures are correct. For example, if there are two ways to ascertain a figure, try to incorporate these two ways in the form of a check total or a proof calculation so that if the two forms of calculation give a different answer it is obvious to the user. Generally, the proof calculation consists of the cell coordinates for the figure you are trying to prove minus the alternative calculation. If the two figures being checked are correct, the resultant answer will be zero.

Check for understanding

5.31 Identify the three types of data that can be entered into a cell.

5.32 Load a spreadsheet program into the computer.

a Use the arrow keys to move to the following positions:

A2	B7
F2	G10
F7	A14

b Use the GOTO command to move to the following positions:

A1	B45
A128	A1
Z86	

c Enter the following labels into the coordinates given:

A1	SPREADSHEET TUTORIAL
A2	YOUR NAME

d Enter the following numbers into the coordinates given:

A4	7
B4	10
C4	21

e Enter the following formulas into the coordinates given:

A6	A4+B4
A7	B4-A4
A8	A4*B4
A9	B4/A4
A10	A4^2
A11	(C4+A4)/B4
A13	SUM(A6:A11)
A14	AVERAGE(A6:A11)
A15	COUNT(A6:A11)
A16	MIN(A6:A11)
A17	ROUND(A9,2)
A18	IF(B4>A4,A6,A7)

f Change B4 to 3. What is the resultant change to cell A18?

g Change the following column widths:

Column	Width
A	25
B	10
C	15
D	10

- h Justify columns A, B and C to the right.
- i Justify cells A1 and A2 to the left.
- j i Format cell A11 to one decimal place.
ii Format cell A14 to whole dollars.
- k Save the worksheet under the name of TUT1.
- l Print the worksheet.
- m Print the worksheet showing formulas.
- 5.33 a **Prepare** the profit model worksheet shown in Figure 5.21. The procedure is:
- Load the spreadsheet package.
 - Move to the following coordinates and enter the following labels:

A1	COST
A2	PRICE
A3	\$
B1	QUANTITY
C1	TOTAL
C2	COST
C3	\$
D1	SELLING
D2	PRICE
D3	\$
E1	TOTAL
E2	REVENUE
E3	\$
F1	PROFIT
F3	\$
 - Move to the following coordinates and enter the following numbers:

A5	5
B5	12
D5	11
 - Move to the following coordinates and enter the following formulas:

C5	$A5*B5$
E5	$D5*B5$
F5	$E5-C5$
- b Save the worksheet under the name of PROFIT and obtain a printout.
- c Justify the worksheet to the right.
- d Widen all columns to a width of 11.
- e Centre the dollar signs under the headings.
- f Format the worksheet so that the Quantity column is in whole numbers and all the other columns show numbers to two decimal places.
- g Unlock A5, B5 and D5, and change the colour of the numbers to blue. Turn on global protection so the user cannot accidentally erase any item.
- h Save the worksheet under the name of PROFIT and print the worksheet.
- i Move to coordinate D5 and enter the number 15. The selling price is now \$15. What is the effect on:
- i total cost?
 - ii total revenue?
 - iii profit?

- j Move to coordinate A5 and enter the number 7. The cost price is now \$7. What is the effect on:
 - i total cost?
 - ii total revenue?
 - iii profit?
 - k Convert the worksheet into a template by entering zeros into the Cost Price, Quantity and Selling Price columns. Save the template under the name PROFITS.
 - l Close the worksheet.
 - m Retrieve the worksheet PROFIT.
 - n Move to coordinate B5 and enter the number 30. The quantity on hand is now 30. What is the effect on:
 - i total cost?
 - ii total revenue?
 - iii profit?
 - o Print the worksheet.
 - p Print the worksheet with formulas.
- 5.34
- a What command is used when formulas are duplicated in a different cell?
 - b **Explain** the difference between absolute and relative copying.
 - c **Describe** how you copy a formula into another two columns.
 - d Enter the number 5 in coordinate A1.
 - e Enter the following formula into B1:
=A1
What is the number in B1 now?
 - f Copy the formula in B1 from C1 to E1 by absolute copying.
 - i What is the output in each of the coordinates?
 - ii What is the formula in each of the coordinates?
 - g Enter the number 10 in coordinate A3.
 - h Enter the following formula in B3:
=A3
What is the number in B3 now?
 - i Copy the formula in B3 from C3 to E3 by relative copying.
 - i What is the output in each of the coordinates?
 - ii What is the formula in each of the coordinates? Is it any different from the formulas in row 1?
 - j Change the number in A1 to 7. Change the number in A3 to 8. Explain the resulting changes.
 - k Change the number in C1 to 2. Change the number in C3 to 12. Explain the resulting changes.
 - l Save as COPY.
 - m Erase the worksheet from the screen.
- 5.35
- a Enter the numbers 1, 2, 3, 4 and 5 in coordinates A1, B1, C1, D1 and E1, respectively.
 - b Enter the numbers 6, 7, 8, 9 and 10 in coordinates A2, B2, C2, D2 and E2, respectively.
 - c Enter the following formula into A4 and A5:
=A1+A2.
 - d Copy the formula in A4 from B4 to E4 using relative copying.
 - e Copy the formula in A5 from B5 to E5 using absolute copying.
 - f **Explain** the difference between the results in row 4 and row 5.
 - g Save as COPY2.
 - h Erase the worksheet from the screen.

5.36 In primary school, you would have learnt your multiplication from something similar to the following:

	A	B	C	D	E	F	G	H	I	J	K	L	M
1	Multiplication Table												
2	×	1	2	3	4	5	6	7	8	9	10	11	12
3	1	1	2	3	4	5	6	7	8	9	10	11	12
4	2	2	4	6	8	10	12	14	16	18	20	22	24
5	3	3	6	9	12	15	18	21	24	27	30	33	36
6	4	4	8	12	16	20	24	28	32	36	40	44	48
7	5	5	10	15	20	25	30	35	40	45	50	55	60
8	6	6	12	18	24	30	36	42	48	54	60	66	72
9	7	7	14	21	28	35	42	49	56	63	70	77	84
10	8	8	16	24	32	40	48	56	64	72	80	88	96
11	9	9	18	27	36	45	54	63	72	81	90	99	108
12	10	10	20	30	40	50	60	70	80	90	100	110	120
13	11	11	22	33	44	55	66	77	88	99	110	121	132
14	12	12	24	36	48	60	72	84	96	108	120	132	144

Source: Microsoft Corporation

Enter Multiplication Table in cell A1 and x in A2. Enter numbers 1 to 12 in cells B2 to M2 and numbers 1 to 12 in cells A3 to A14.

Enter a mixed formula in cell B3. The contents of the formula should be such that you should be able to copy B3 to C3:M3 and then copy B3:M3 to B4:M14 without changing the formula.

(Hint: some references will be absolute and others will be relative.)

5.37 Prepare a worksheet for a ‘T’ form of ledger with appropriate column widths, and ledger account names and numbers that can be easily changed for any exercise. Also prepare a worksheet for a columnar ledger.

5.38 Prepare a worksheet for a trial balance that can be easily changed for any exercise.

5.39 Adam Benston is the owner of a new type of storage business called U Store. He offers customers the service of providing secure, garage-style storage. Each garage has a roller door, and the customer is given the only key to that door. Customers have access to the facility 24 hours a day.

Most of the customers are people who are moving house and require short-term storage facilities, and small businesses that do not have the space to store excess inventories on their premises.

Adam is becoming frustrated at the amount of time it takes to give a customer a quote. This is because the cost of this type of storage is dependent upon the following:

- the number of weeks required
- the volume of the garage in cubic metres
- the value of the goods.

A customer will ring and give him some details. Depending upon the quoted price, the customer will then ask how much it would cost to hire a larger or smaller garage, or to increase or decrease the number of weeks. Each new set of circumstances results in a new set of calculations.

Hearing that you know how to use spreadsheets, Adam asks you to design a suitable worksheet. All the data to be input and the resultant output must fit on one screen. He wants to be able to enter details for six quotes so that he can easily change the variables according to customer requirements. When the customer has decided which quote is required, Adam will write the details into his quote book.

He gives you the following details for charging:

- Size of garages (in metres):

Volume (cubic metres) =	L	×	B	×	H
	3	×	3	×	2.5
	4	×	4	×	3
	5	×	5	×	3
	6	×	6	×	3
	8	×	8	×	4

- The volume charge is 22 cents per cubic metre per week.
 - Minimum hire period is two weeks.
 - A once-only hire charge of \$35 is made.
 - A weekly charge for insurance of 0.15 per cent of the value of the goods stored is made.
- As an example, if a customer wanted to choose a 4 × 4 × 3 garage for two weeks with \$4000 worth of goods, the fee would be \$68.12.

The following is a typical report.

	A	B	C	D	E	F	G
1	REPORT						
2	Size of Garages:		L x B x H		Volume		
3							
4			3 x 3 x 2.5		22.5		
5			4 x 4 x 3		48		
6			5 x 5 x 3		75		
7			6 x 6 x 3		108		
8			8 x 8 x 4		256		
9							
10	Quote:	1	2	3	4	5	6
11							
12	Volume	48	75	108	48	75	0
13	No of Weeks	2	2	2	4	4	4
14	Value of Goods \$	4000	4000	4000	4000	4000	4000
15	Amount of Quote \$	68.12	80.00	94.52	101.24	125.00	59.00
16							

The cells in B12 to G14 must be unlocked to allow input of data. Proofs can also be used to check the accuracy of input.

You are required to:

- design and build the worksheet to meet the above specifications. Save the worksheet as QUOTE.
- build a proof to check the accuracy of the quote. (This is challenging. It will require the use of IF, AND and OR statements. For example, what happens if the user accidentally enters 58 instead of 48 for the volume, or enters a period less than two weeks?)

Business graphics in spreadsheets

Instead of the accountant simply reporting lists of figures, these figures can now be converted into a graphic presentation for greater visual effect. The proverb ‘a picture is worth a thousand words’ can be applied readily to this type of software. A major reason for graphics becoming so popular is the ease of use of such packages.

Spreadsheets generally have a graphics element that allows the pictorial representation of numeric data. In Microsoft Excel, a Chart Ribbon allows the easy conversion of numbers to graphs. As shown in Figure 5.23, in the Chart Ribbon the user must choose the type of graphic to be displayed.

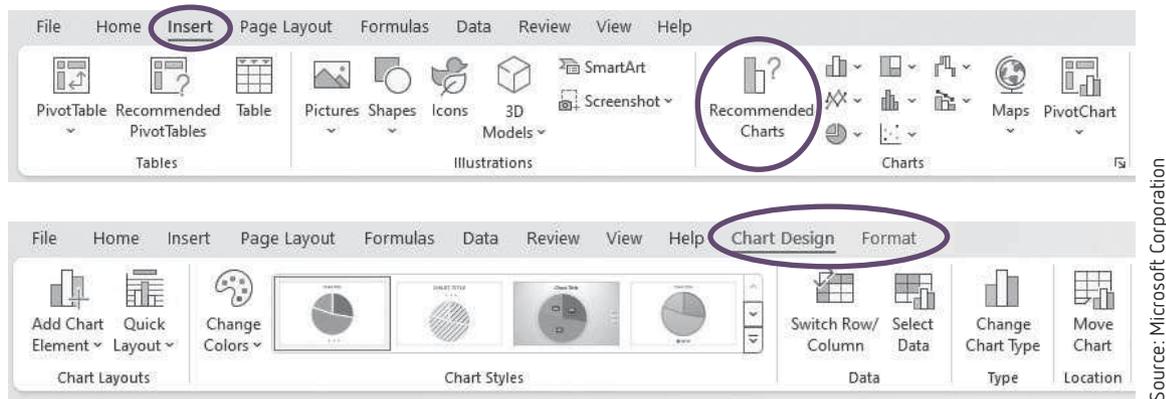


Figure 5.23 Microsoft Excel ribbon to Insert a Chart (top) and to Design and Format a chart (bottom)

There is a range of chart (graph) types available. However, the three most common forms of charts used to display numerical data are the bar chart, pie chart and line chart. Table 5.3 will help you decide which chart is the best in particular circumstances.

Table 5.3 Circumstances in which some common charts are used

Circumstance	Chart
Change over time	Column or bar
	Line
	Area
Emphasise part of a whole	Pie
Trends	Line
Correlation	Scatter (point)

- Column or bar charts.** These show the relationship between two elements, in the form of a bar or column, such as the relationship between revenue and the months of the year. These two elements are placed on the x and y axes of the graph in Figure 5.24 and the relationship between the two elements can be easily seen.

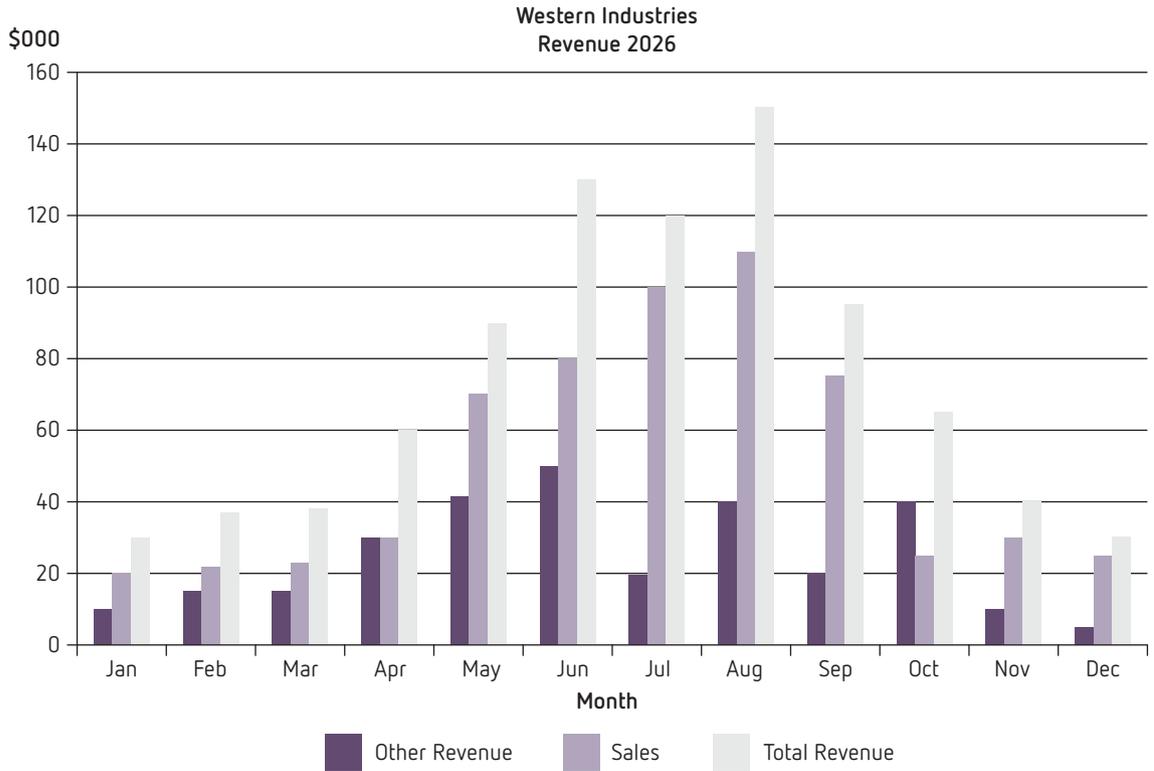


Figure 5.24 Column or bar chart

- **Stacked bar charts.** These show the total of one of the elements, as well as the individual parts that make it up, as in Figure 5.25.

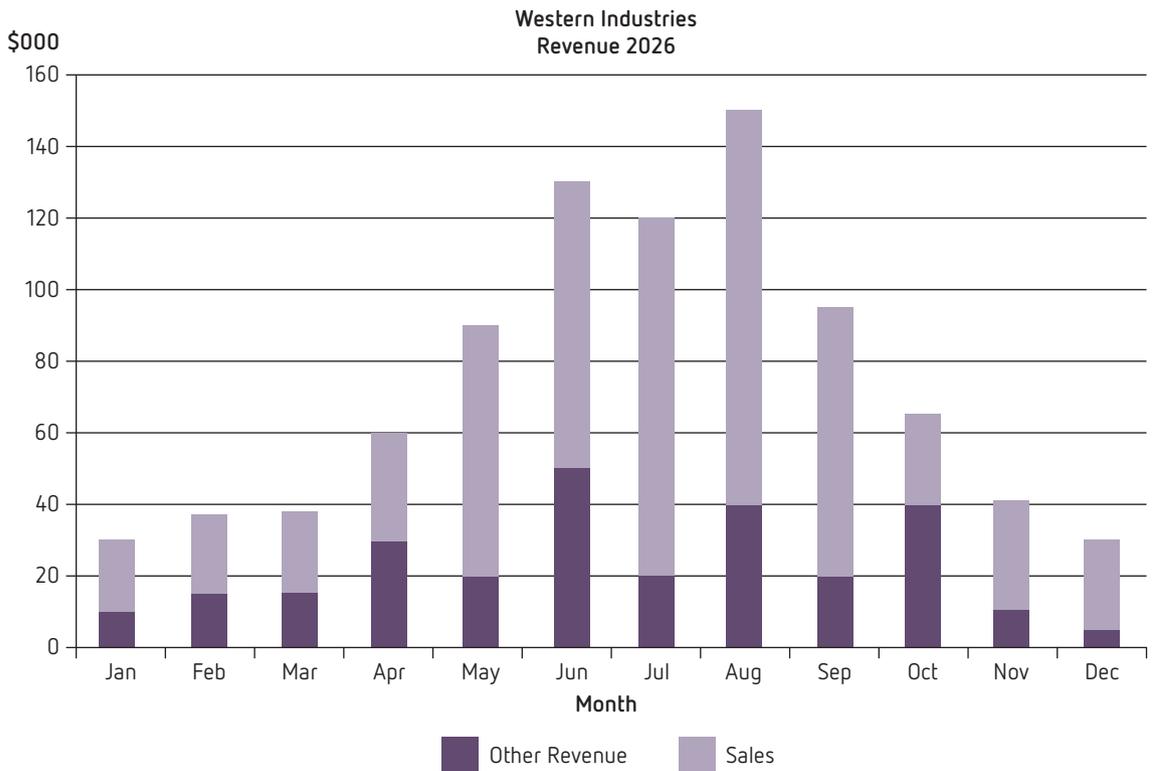


Figure 5.25 Stacked bar chart

- Pie charts.** Pie charts show, in the form of a circle, the relationship between individual elements as a percentage of the whole (see Figure 5.26). Because a pie chart only shows one range, it is not suitable for all situations. However, it is very easy for the reader to understand.

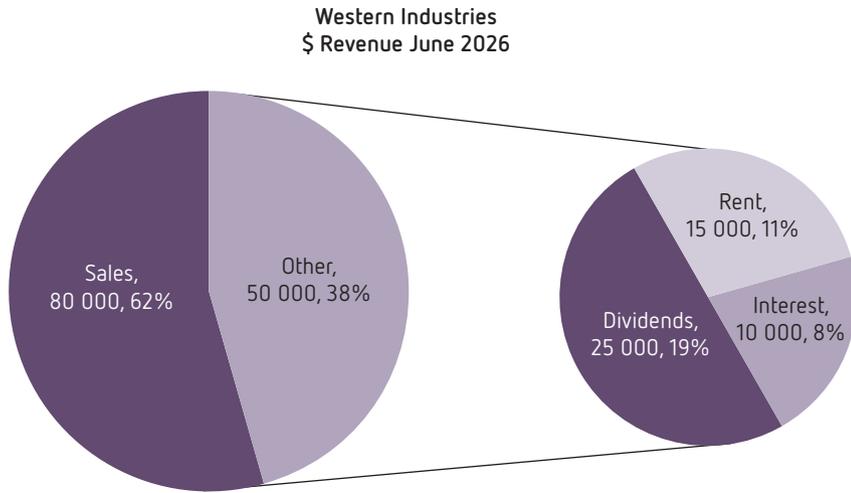


Figure 5.26 Pie chart

- Line charts.** These connect a set of plotted points, as shown in Figure 5.27, and are therefore best used to show change.

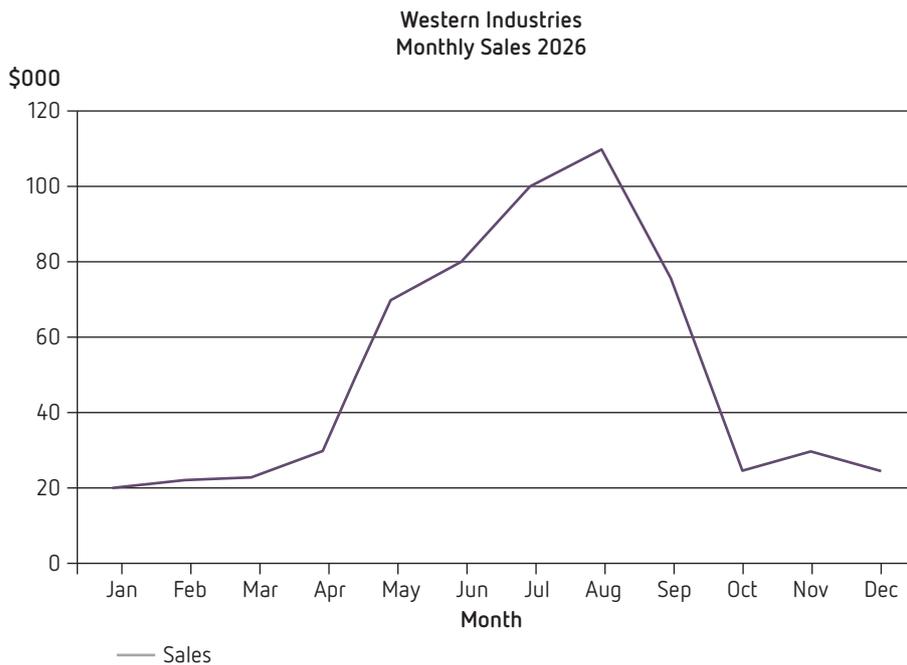


Figure 5.27 Line chart

Other features include the following:

Scaling This enables the user to define the scale to be used on each of the axes. Requirements include the lowest and highest points and the number of divisions or increments. All of this can be done automatically if required.

Labelling This enables the user to clarify what the chart is trying to portray. The title of the chart, the name of each axis and a legend to name the various elements of the chart (such as segments in a pie chart or layers in a stacked bar chart) must be entered. Floating labels in appropriate places might be used to emphasise certain key points.

Check for understanding

5.40 Prepare a line chart, a bar chart and a pie chart for Crustation Ltd that shows net profit in the following years:

	\$000
2017	34 653
2018	41 428
2019	53 498
2020	33 569
2021	56 183
2022	75 921
2023	83 702
2024	90 437
2025	91 036
2026	95 665

5.41 Freeman Industries would like you to show the following data in graphic form.

	Sales	Other revenue	Total
2026	\$	\$	\$
January	120 000	10 000	130 000
February	138 000	5 000	143 000
March	85 000	7 500	92 500
April	75 000	2 000	77 000
May	87 000	2 000	89 000
June	93 000	4 000	97 000
July	84 000	5 000	89 000
August	74 000	1 000	75 000
September	79 000	5 000	84 000
October	98 000	4 000	102 000
November	105 000	6 000	111 000
December	138 000	7 000	145 000

The managers are not too sure which will be the best graph, so they ask you to **prepare a:**

- bar chart with a data table
- stacked bar chart with a data table
- line chart.

- a Which one do you think shows the information most clearly and concisely? Why?
 b Show January's figures as a pie chart.
 c January's other revenue is made up of:

Interest	\$1000
Commission	\$7000
Dividends	\$2000

Show January's figures as a pie chart with the other revenue as a cut slice, and the slice linked to a second pie chart showing the details that make up the other revenue.

- 5.42 **Prepare** a pie chart for Vantu Co showing details of sales for the year ended 30 June 2026.

	\$000		\$000
Consumer products	1 281	Industrial products	1 134
Electrical products	679	Medical products	753

- 5.43 You are given the following data about the business of Teeny International Consolidated for the year ended 31 December 2025:

	Profit		Profit
	\$000		\$000
Australia	4 582	USA	23 639
New Zealand	1 437	Europe	15 781
Asia	8 420		

Prepare the best type of chart to portray this information.

CHAPTER REVISION

5.44 Multiple choice

Complete the following multiple-choice questions by choosing the best answer.

- 1 Which of the following is not generally an issue when choosing an accounting package for a large organisation?
 - A Importing data
 - B Storage and security of the data
 - C digitising external source documents and communications
 - D None of the above
- 2 Which of the following is an incorrect statement?
 - A A flexible chart of accounts is a common feature of an accounting package.
 - B Accounting packages process transactions using many journals.
 - C It should be assumed that technology will fail, so appropriate backup procedures must be considered.
 - D Accounting packages are often menu-driven or graphical interface-driven.
- 3 A typical report generated from a general ledger accounting package would be:
 - A a payroll register
 - B an inventory listing
 - C statements of account
 - D a Statement of Profit or Loss.
- 4 Control accounts can be set up for which of the following subsidiary ledgers?
 - A Accounts payable
 - B Accounts receivable
 - C Inventories
 - D All of the above
- 5 In a subsidiary ledger:
 - A a debit entry means a similar debit entry will be made in the control account
 - B a listing showing the balances of all accounts will total the balance of the control account
 - C if the total of all balances is credit, then the control account balance will be credit
 - D all of the above.
- 6 When using the control account/subsidiary ledger technique:
 - A debit will equal credit in each subsidiary ledger
 - B the only subsidiary ledgers that can be used are for accounts receivable and accounts payable
 - C a trial balance will be prepared from the general ledger
 - D all of the above.
- 7 Using the control account/subsidiary ledger technique, the receipt of an original tax invoice for \$2640 including GST from Johanes Ltd will result in:
 - A a debit entry to Johanes Ltd and a credit entry to the Accounts Receivable Control account for \$2400
 - B a debit entry to Johanes Ltd and a debit entry to the Accounts Receivable Control account for \$2640
 - C a credit entry to Johanes Ltd and a credit entry to the Accounts Payable Control account for \$2640
 - D a credit entry to Johanes Ltd and a debit entry to the Accounts Payable Control account for \$2400.
- 8 Using the control account/subsidiary ledger technique, a deposit from Manderson Ltd of \$13 200 in the credit column of the business's bank statement will result in:
 - A a debit entry to Manderson Ltd and a debit entry to the Accounts Receivable Control account for \$13 200
 - B a credit entry to Manderson Ltd and a credit entry to the Accounts Receivable Control account for \$13 200
 - C a debit entry to Manderson Ltd and a debit entry to the Accounts Payable Control account for \$13 200
 - D a credit entry to Manderson Ltd and a credit entry to the Accounts Payable Control account for \$13 200.

- 9 Which of the following is correct?
- A Inventories and supplies are both assets.
 - B Supplies are purchased with the intention of resale.
 - C Inventories are purchased with the intention of using them in the performance of services.
 - D None of the above.
- 10 The following information relates to the inventory transactions of a firm:
- | | | | |
|---------------------------|---------------------|--|-----------|
| Inventories balance Feb 1 | | | |
| 2000 units @ \$5 | | | \$10 000 |
| Purchases Feb 7 | 7000 units @ \$6 | | \$42 000 |
| Purchases Feb 27 | 5000 units @ \$7 | | \$35 000 |
| Sales Feb 28 | 10 000 units @ \$10 | | \$100 000 |
- Assuming a weighted average costing method, what is the Cost of Goods Sold for the month?
- A \$62 143
 - B \$58 214
 - C \$65 000
 - D \$24 857
- 11 If a business sold goods on credit to Lau Pty Ltd using a tax invoice totalling \$14 300 (with all items having GST), which of the following will be correct in the accounting records?
- A Debit Lau Pty Ltd in the Accounts Receivable ledger for \$14 300 and debit the Accounts Receivable Control account for \$14 300.
 - B Decrease the quantity sold for each item at cost price in the Inventory ledger (Stock Item record) and credit the Inventories Control account for the total cost price of all items sold.
 - C Credit the Sales account for \$13 000, credit the GST Collected account for \$1300 and debit the Cost of Goods Sold account for the total cost price.
 - D All of the above.
- 12 Which of the following is not a basic element that can be entered into a cell of a spreadsheet?
- A Template
 - B Formula
 - C Label
 - D Number
- 13 A relative copying into column D of the formula =C5+C6 in cell C7 would be:
- A D7 is =C5+C6
 - B C7 is =D5+D6
 - C D7 is =D5+D6
 - D none of the above.
- 14 In relation to spreadsheets, which of the following is incorrect?
- A Labels are only made up of alphabetic characters.
 - B Formulas make the worksheet powerful.
 - C Labels are used for descriptive text.
 - D Numbers ensure that calculations can be easily performed.
- 15 In a spreadsheet, accuracy is vital as decisions are made based on the output. Which of the following would not result in accurate output?
- A The use of proofs
 - B Protecting cells
 - C Saving the worksheet at a meaningful starting position
 - D Manually checking all output with a calculator
- 16 Spreadsheets can be used for:
- A customer records
 - B sales forecasting
 - C inter-office communications
 - D moving paragraphs in a letter.
- 17 Graphics can be used to show:
- A a list of figures in a vertical line
 - B 'what if' situations
 - C a pictorial representation of figures
 - D a list of employees stored on the computer.

5.45 Case study

STIMULUS 1

Accounts Receivable Control				No 2105	
Date	Particulars	Amount	Date	Particulars	Amount
Oct 1	Balance	19 000	Oct 3	Cash Jahru Bros	7 000
12	Sales R Manderson	9 900	14	Sales Ret Peterson Ltd	178
			31	Balance c/d	21 722
		<u>\$28 900</u>			<u>\$28 900</u>
Nov 1	Balance b/d	21 722			

STIMULUS 2

Accounts Payable Control				No 4101	
Date	Particulars	Debit	Credit	Balance	
Feb 1				64 000 Cr	
7	Inventories Jay Suppliers		20 389	84 389 Cr	
8	Cash Howard & Co	14 570		69 819 Cr	
23	Inventories Mayon Ltd		930	70 749 Cr	
24	Inventories Monda Ltd	2 870		67 879 Cr	

STIMULUS 3

Inventories Control				No 3106	
Date	Particulars	Debit	Credit	Balance	
May 1				120 000 Dr	
2	Cash	7 650		127 650 Dr	
3	Accounts Payable Fruion Ltd	21 730		149 380 Dr	
4	Cost of Goods Sold		12 610	136 770 Dr	
19	Accounts Payable Adamson Ltd		18 800	117 970 Dr	
21	Cost of Goods Sold		2 675	115 295 Dr	
24	Cost of Goods Sold	2 340		117 635 Dr	
26	Inventory Adjustment		1 200	116 435 Dr	

For each of the above independent stimuli, **analyse** the account and, for each entry, **describe** what has happened.

5.46 Case study

STIMULUS 1 – DETAILS OF BUSINESS

On 1 June, R Watson had various assets and liabilities for her business, Java Enterprises, which sells very specialised chemical supplies. The business operates from 189 Montange Road, Townsville, Qld 4810, with ABN 83 481 328 344.

STIMULUS 2 – BALANCE SHEET DETAILS 1 JUNE

Assets: Cash at Bank \$900, Accounts Receivable \$2000, Inventories \$1000, Land \$40 000 and Buildings \$10 000.

Liabilities: Accounts Payable \$1000.

Accounts Receivable Listing

M Flynn	\$1 500
A Summers	\$500

Accounts Payable Listing

R James	\$1 000
---------	---------

Inventories Listing

Product X 200 units @ \$2 \$400
Product Y 600 units @ \$1 \$600

STIMULUS 3 – TRANSACTIONS FOR JUNE (WITH APPLICABLE GST)

June	2	Sold 100 units of product X to M Flynn for \$4.40 each.
	10	Purchased 700 units of product X from T Adams for \$3.30 each
	14	Returned 20 units of product X to T Adams.
		Sold 500 units of product Y to S Masters for \$3.30 each.
	15	Purchased 600 units of product X from C Race for \$3.30 each.
	16	S Masters returned 10 units of product Y.
	20	Purchased 900 units of product Y from R James for \$2.20 each.
	21	Sold 700 units of product Y to A Summers for \$4.40 each.
	22	Paid freight inwards on product Y \$55.
	23	Paid wages \$300.
	25	Sold 900 units of product X to M Flynn for \$5.50 each.

STIMULUS 4

INVENTORY STOCKTAKE SHEET (Extract)			
30 June			
Java Enterprises 189 Montange Road Townsville, Qld 4810 ABN 83 481 328 344			No 1
Stock No	Description of Unit	No of Units	Count on Hand
34892	Product X	Each	460
34904	Product Y	Each	300

Refer to the above stimuli and, using an accounting package such as MYOB or Reckon, the perpetual inventory system (weighted average method) and assuming GST, show the:

- a general ledger accounts, including Sales, Cost of Goods Sold, Inventory Adjustment, Inventories Control, Accounts Receivable Control and Accounts Payable Control
- b trial balance
- c Statement of Profit or Loss and Statement of Financial Position
- d Accounts Receivable listing
- e Accounts Payable listing
- f Inventory listing.

UNIT 2

FINANCIAL REPORTING

One of the main objectives of accounting is to provide **information for decision making**. The recording process must therefore ensure that all relevant data are recorded and reports such as the Statement of Profit or Loss, Statement of Financial Position and Statement of Cash Flows are prepared. This means that accrual accounting is implemented and relevant balance day adjustments are recorded. As a result, the information coming from the accounting system in the form of financial reports will be generated in a timely manner and will be complete and accurate.

Another objective of accounting is to assist in **discharging accountability**. Internal control is a major factor in ensuring that this objective is achieved. The various controls that can be incorporated into the accounting system will be examined with particular reference to accounts receivable, accounts payable and inventories.

Evaluating performance is a key objective of accounting. For a sole trader business, this involves using tools to assess how efficiently resources are being used, particularly to earn profits, and how liquid and financially stable the business is moving into the future. The analysis and interpretation of the financial reports allows decisions to be made and communicated to interested parties.

6

END OF PERIOD REPORTING

LEARNING OBJECTIVES

At the end of this chapter you should be able to:

- describe the accounting period concept and the concept of balance day adjustments
- synthesise accounting principles and processes to record balance day adjustments, closing entries and reversing entries
- synthesise accounting principles and processes to prepare the end of period Statement of Profit or Loss, Statement of Financial Position and Statement of Cash Flows
- explain the effect of closing and reversing entries
- prepare a Bank Reconciliation Statement
- synthesise using computerised accounting processes to record balance day adjustments and generate end of period reports
- synthesise using spreadsheet features and functions to build a spreadsheet showing a Statement of Profit or Loss, a Statement of Financial Position and relevant graphs
- analyse and interpret the results for a sole trader business and make recommendations about future performance.

*End of period reporting***Accounting period and profit determination**

- Income and revenue
- Expenses
- Accrual accounting
- End of period process

Preparation and presentation of the Statement of Profit or Loss**Preparation and presentation of the Statement of Financial Position****Preparation of the Bank Reconciliation Statement****Preparation and presentation of the Statement of Cash Flows**

- Presentation of the Statement of Cash Flows

Combined Illustrative example of the Statement of Profit or Loss, Statement of Financial Position and Statement of Cash Flows**Balance day adjustments**

- Accruals
- Prepayments

The adjusted trial balance and end of year financial statements for a service organisation

- Preparation of an adjusted trial balance
- Preparation of the financial statements
- Closing entries
- Reversing entries

Preparation of end of year financial statements for a trading organisation

- GST clearing entries
- Preparation of the financial statements for a trading organisation
- Return on owner's equity
- Accounting technology – spreadsheets and accounting packages

Chapter revision

Weblinks:

- Statement of Cash Flows (p.244)
- Woolworths Limited annual report (p.284)



 Nelson MindTap

To access resources above, visit
cengage.com.au/nelsonmindtap

Accounting period and profit determination

Many concepts and principles underlie the preparation of accounting records. At this stage, it is necessary to take a closer look at one of these: the **accounting period concept**.

For accounting purposes, the accounting period concept assumes that the life of a business is divided into arbitrary time periods.

We generally assume that most businesses will continue operations for many years (perhaps even indefinitely). Indeed, an absolutely accurate determination of profits can be made only after the liquidation of a business, when it ceases operating. However, many parties are interested in the financial results of an organisation; for example, owners, creditors or the Australian Taxation Office (ATO). They cannot wait until liquidation occurs. They wish to know how the business is progressing on a more regular and periodic basis.

Accounting periods are generally a month, a quarter, six months or a year. This chapter will concentrate on monthly reporting for the purposes of management.

For every accounting period, the aim is to calculate a profit figure that is as accurate as possible.

Income and revenue

Profit is the main measure of performance for most businesses. It is determined by deducting expenses from income. You should note that up to this point we have referred to revenue rather than income. So let's now examine the relationship between revenue and income.

The definition of income is complex. It is defined in the Accounting Standards Board (AASB) *Framework for the Preparation and Presentation of Financial Statements* (the *Framework*) as follows:

Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.¹

In other words, income includes both revenue and gains. These gains include unrealised gains on the revaluation of marketable securities, gains on the revaluation of property, exchange differences on translation of foreign operations, changes in the fair value of cash flow hedges and actuarial gains/losses on defined benefit superannuation plans. These types of gains are shown in a Statement of Comprehensive Income and as such fall outside the scope of this book.

¹ *Framework for the Preparation and Presentation of Financial Statements*, AASB, 2010, para 70(a), p. 17. https://www.aasb.gov.au/admin/file/content105/c9/Framework_07-04_COMPmay19_01-20.pdf

Revenue is defined in the *Framework* as increases in economic benefits **arising in the course of the ordinary activities of an entity**. Examples of revenue items are service revenue, sales revenue, dividends, interest and rent. Our focus in this book is on revenue:

$$\text{Profit} = \text{Revenue} - \text{Expenses}$$

While the above explanations assist us in knowing *what* revenue is composed of, it is also important to consider *when* revenue is to be recorded in the accounts. This process is known as **revenue recognition**.

The earning of revenue is a process and often involves a number of steps. For example, imagine your mobile phone needs repairing. You drop the phone off to the service agent on 27 June. They fix your phone on 30 June. On 1 July the agent calls to say your phone is ready to be collected and on 2 July you collect the phone and pay for the repairs. From the business's point of view, when has it earned the revenue? There are a number of points that could be considered because the process of earning revenue usually occurs over a period of time. However, as a basic rule, revenue should be recognised in the accounting period in which the service is performed. In this example, the revenue was earned on 30 June when the phone was fixed, even though the cash was not received until 2 July.

The stage at which accountants usually choose to recognise revenue for trading concerns is at the point of delivery of the goods because then there is a legal obligation binding on the purchaser. The organisation is therefore more assured of receiving its money.

Revenue is recognised when it has been earned. For a service business, this means when the service has been performed. For a trading concern, this means when goods are delivered.

Expenses

As discussed in Chapter 3, expenses comprise such items as wages and salaries, electricity and interest on loans.

To decide the applicable accounting period for expenses, it is necessary to relate the expenses back to the revenue they helped earn. Once it is decided to recognise revenue in a certain accounting period, the expenses incurred in order to earn that revenue must also be recognised in that period, irrespective of when they were paid.

Accrual accounting

The basis of accounting commonly used by most businesses is the **accrual basis**.

The accrual basis of accounting recognises transactions and events when they have an economic impact on the entity rather than when the associated cash flows occur.

This means that assets, liabilities, revenues and expenses arising from transactions or other events will be recognised in the financial statements of an entity when the effects occur (i.e. when revenue is earned and expenses are incurred), rather than when amounts are received or paid. The adoption of accrual accounting will result in balance day adjustments being made to ensure that assets, liabilities, revenues and expenses are recognised in the correct reporting period. Accrual accounting is to be contrasted with

cash accounting, where the effects of transactions are recognised only when cash is received or paid out. Cash accounting is still sometimes used in service industries, and was previously used by some government agencies.

Real-world application



Accrual accounting

In the 1990s, governments in Australia and around the world began using accrual accounting for their agencies. However, the change to accrual methods is by no means without criticism. The proponents of accrual accounting suggest it gives an improved measure of the cost of providing the services of government, matches these costs better with revenues, and focuses more clearly on asset management. The opponents of accrual accounting dispute these claims and argue that cash accounting provides information on the accountability of government agencies in using the funds appropriated to them. The debate now seems to have been settled in favour of accrual accounting, and all government agencies in Australia have moved to implement the accrual basis of accounting.

Check for understanding

- 6.1 **Explain** the meaning of the accounting period concept.
- 6.2 'Revenue is earned when cash is received.' **Analyse** this statement and **create** a paragraph(s) giving your reasons for your disagreement or agreement.
- 6.3 **Explain** the difference between accrual accounting and cash accounting.

End of period process

The prime function of accounting is to present information to interested parties, and we have already seen in Chapter 1 that there are three main reports: a Statement of Profit or Loss, a Statement of Financial Position and a Statement of Cash Flows. These reports are prepared outside the ledger; that is, they are reports, not ledger accounts, and are always prepared at the end of the financial year for legal reasons, but may be prepared as often as required for management purposes.

We will now deal with each of these financial reports in more detail.

Preparation and presentation of the Statement of Profit or Loss

A Statement of Profit or Loss is prepared outside the ledger for presentation to interested parties, detailing the various revenues and expenses for a period and calculating the resultant profit or loss.

Let us prepare a Statement of Profit or Loss for a painter – J Harrison. It is a relatively uncomplicated business with a small number of revenue and expense items, some of which are quite specific to a painter.

J Harrison		
Statement of Profit or Loss for year ended 30 June 2026		
	\$	\$
Revenue		
Service Fees Revenue		50 000
Less Expenses		
Hire of Trestles and Ladders	1 500	
Paint	10 000	
Supplies	1 000	
Vehicle Expenses	3 000	
Telephone and Postage	500	
Wages of Apprentice	<u>7 000</u>	<u>23 000</u>
Net profit		<u><u>\$27 000</u></u>

Check for understanding

6.4 **Analyse** the following information for Saxon Real Estate and **prepare** a Statement of Profit or Loss.

Saxon Real Estate		
Trial Balance (extract) as at 31 December 2026		
Account	Debit \$	Credit \$
Bank Charges	100	
Interest Expense	500	
Office Wages	7 000	
Fees		150 000
Sales Salaries	25 000	
Telephone	500	
Sales Commission	5 000	
Advertising	4 000	
Rent	2 000	
Office Expenses	1 500	
Rates	1 000	
Stationery Expenses	200	
Rent Revenue		200

- 6.5 **Analyse** the following information for Majestic Agents and Services and **prepare** a Statement of Profit or Loss for the year ended 30 June 2026.

Majestic Agents and Services		
Trial Balance (extract) as at 30 June 2026		
Account	Debit	Credit
	\$	\$
Office Expenses	500	
Interest Expense	1 000	
Service Fees		20 000
Supplies Expense	5 000	
Motor Vehicle Expenses	4 000	
Commission Revenue		50 000
Office Wages	15 000	
Advertising	2 000	
Telephone Expense	100	

- 6.6 **Analyse** the following ledger accounts for H Harold, trading as Harold's Electrical Services, at 30 June 2026 and **prepare** the Statement of Profit or Loss for the year ended 30 June.

Drawings		Interest Expense	
\$1 000		\$1 500	
Rent Expense		Service Fees Revenue	
\$1 200			\$15 000
Advertising		Supplies Expense	
\$500		\$10 500	
Capital		Insurance	
	\$10 000	\$1 000	
Motor Vehicle Expenses			
\$2 000			

Preparation and presentation of the Statement of Financial Position

A Statement of Financial Position is a detailed expression of the accounting equation for a business at a certain point in time. It is a major report that lists the various asset, liability and owner's equity items.

An example of a Statement of Financial Position presented in both account form and narrative form is given here. The order of items is generally that of the chart of accounts on page 349. Detailed classification will not be demonstrated at this stage but will be covered in Unit 3.

Extra detail is usually given in the owner's equity section to show how profits and drawings affect the owner's interest in the business. All profits or losses belong to the owner. The link between the Statement of Profit or Loss and the Statement of Financial Position is therefore profit (or loss) and its effect on owner's equity.

Both the account and the narrative forms of presentation are used in practice. The narrative form has the advantage of being more readily understood by people without an accounting background and is more easily adapted to showing comparative figures for two accounting periods. It is usually presented in the form of the accounting equation $A - L = OE$.

a Account form

C Dart					
Statement of Financial Position as at 30 June 2026					
	\$	\$		\$	\$
Assets			Liabilities		
Cash at Bank		2 000	Accounts Payable		
Accounts Receivable			Simone & Co	500	
L Hunter	1 000		Durant Ltd	<u>1 500</u>	2 000
V Campbell	<u>1 500</u>	2 500	Mortgage		7 000
Supplies		11 000	Loan from Finance Co		<u>310 000</u>
Shares in XYZ Co		1 500			319 000
9% Debentures		1 200	Owner's Equity		
Vehicles		12 000	Capital (1 July 2025)	170 000	
Furniture		12 000	Add Net profit	<u>20 000</u>	
Buildings		125 000		190 000	
Land		325 000	Less Drawings	<u>4 300</u>	185 700
Goodwill		11 000			
Patents		<u>1 500</u>			
		<u>\$504 700</u>			<u>\$504 700</u>

b Narrative form

C Dart			
Statement of Financial Position as at 30 June 2026			
	\$	\$	\$
Assets			
Cash at Bank		2 000	
Accounts Receivable			
L Hunter	1 000		
V Campbell	<u>1 500</u>	2 500	
Supplies		11 000	
Shares in XYZ Co		1 500	
9% Debentures		1 200	
Vehicle		12 000	
Furniture		12 000	
Buildings		125 000	
Land		325 000	
Goodwill		11 000	
Patents		<u>1 500</u>	504 700
Less Liabilities			
Accounts Payable			
Simone & Co	500		
Durant Ltd	<u>1 500</u>	2 000	
Mortgage		7 000	
Loan from Finance Co (due on 1 Feb 2032)		<u>310 000</u>	<u>319 000</u>
Net assets			<u>\$185 700</u>
Owner's Equity			
Capital (1 July 2025)		170 000	
Add Net Profit		<u>20 000</u>	
		190 000	
Less Drawings		<u>4 300</u>	<u>\$185 700</u>

Check for understanding

- 6.7 **Analyse** the following information and:
- a **calculate** the capital at 31 December 2026
 - b **prepare** a Statement of Financial Position for R Peeters:
 - i in account form
 - ii in narrative form.

	Debit \$	Credit \$
Capital (1 Jan 2026)		25 000
Equipment	8 000	
Cash at Bank	1 000	
Accounts Receivable	12 000	
Mortgage		4 000
Investments	7 000	
Patents	500	
Vehicles	4 000	
Supplies	3 000	
Accounts Payable		8 000
Land	10 000	
Loan from Bank		1 000
Drawings	2 500	
<i>Additional information</i>		
Profit for the year ended 31 December 2026 is \$10 000.		

6.8 Analyse the following information of S Barton, trading as Barton Cleaning.

Fees		B Call	
	\$100 000		\$1 750
Cash on Hand		Equipment	
\$100		\$2 000	
J Jones		Land	
\$750		\$40 000	
Shares in ABC Co		Supplies Expense	
\$2 000		\$27 000	
Supplies		Rent Revenue	
\$9 000			\$1 850
Patents		A Lingard	
\$3 000		\$110	
Office Furniture		Buildings	
\$8 000		\$13 000	
Miller Pty Ltd		Commission Revenue	
	\$1 000		\$750
Drawings		Postage	
\$1 000		\$750	
Interest Expense		Hutton Ltd	
\$1 000			\$150
Van Expenses		Loan	
\$750			\$9 000
Advertising		Office Salaries	
\$2 500		\$1 000	
Electricity		Van	
\$250		\$10 000	
Interest Revenue		Insurance	
	\$100	\$250	
Cash at Bank		Capital – S Barton	
\$2 000			\$28 360
Goodwill			
\$15 000			

Prepare a Statement of Profit or Loss for the month ended 30 June and a Statement of Financial Position in narrative form at 30 June.

Preparation of the Bank Reconciliation Statement

As the bank is an external party and all receipts and payments are processed through the bank, then our records and the bank's records should agree. However, sometimes due to timing differences, there can be transactions that are recorded in our books that the bank doesn't know about and vice versa.

As discussed in Chapter 4, an important point to understand is that the bank's records and our records are recorded from different perspectives of the one transaction. Whenever money is deposited and recorded as an increase in our Cash at Bank account (a debit), from the bank's point of view, that money can be withdrawn at any time. The bank owes the business the amount of these deposits and, as amounts owed are liabilities, a credit entry is made in the bank's books. Thus, whenever money is deposited by the business, a debit entry in the business's records corresponds to a credit entry in the bank's records. What is an asset to the business is a liability to the bank.

Whenever a business takes money out of the bank, the withdrawal is a decrease in the Cash at Bank account and therefore a credit entry is made. To the bank, the withdrawal represents a decrease in the amount owed to the business (a liability that is decreasing) and therefore a debit entry is made. Thus, whenever a business withdraws money from the bank by way of a cheque or electronic payment, a credit entry is recorded in the business's records and this corresponds to a debit entry in the bank's records.

A bank reconciliation is done to reconcile our cash records with the bank's records. The process can be undertaken at any time but would always be done at the end of the financial year to ensure that our ledger accounts were up to date before preparing the final end of period reports.

The purpose of the bank reconciliation is to show that agreement exists between the business's cash records and the bank's records.

The steps involved are:

- compare the cash receipts in our records with the credit column of the bank statement
 - if an item appears in our records but not in the bank statement, then it goes into the bank reconciliation (e.g. outstanding deposits)
 - if an item appears in the bank statement but is not in our records, then it is entered into our cash records (e.g. interest received)
- compare the cash payments in our records with the debit column of the bank statement
 - if an item appears in our records but not in the bank statement, then it goes into the bank reconciliation (e.g. outstanding payments)
 - if an item appears in the bank statement but is not in our records, then it is entered into our cash records (e.g. bank fees).

An example of a Bank Reconciliation Statement is as follows:

Bank Reconciliation Statement as at 30 June 2026	
Credit balance as per bank statement	30 000
<i>Add</i> outstanding deposits	<u>5 000</u>
	35 000
<i>Less</i> outstanding payments	<u>10 000</u>
Debit balance as per Cash at Bank account	<u><u>\$25 000</u></u>

Let us also assume that the comparison process revealed \$1000 of bank fees and \$5000 of bank interest in the bank statement, which were not recorded in our accounts. These would be entered into the general journal and posted to the Cash at Bank account.

Check for understanding

6.9 Analyse the following information concerning Arika Enterprises at 30 June 2026.

The accountant has completed all transaction processing and wishes to complete the end of year financial statements. Before this is done, a comparison is made of the Cash at Bank transactions and the bank statement. The following is revealed:

Balance of Cash at Bank account is \$24 060 Dr.

Arika's bank balance as per the bank statement is \$6000 Cr.

The bank has charged bank fees of \$60, which have not been recorded in Arika's records.

A deposit of \$18 000 made on 30 June is recorded in Arika's records but not the bank's records.

Prepare the Bank Reconciliation Statement at 30 June 2026 and any additional records needed to enable the accountant to prepare the final financial statements.

Preparation and presentation of the Statement of Cash Flows

We have already examined the process of preparing a simple Statement of Cash Flows in Chapter 2. Our focus now is the preparation of a Statement of Cash Flows at the end of the reporting period as part of the suite of end of year financial reports.

All the items that affect cash flows must be shown. The results of all these flows are reflected in the changes to the cash position and the final cash balances.

As discussed in Chapter 2, the basic statement classifies cash flows under three main headings:

- Operating activities
- Investing activities
- Financing activities.

The cash receipts and payments for each of the three main types of cash flows are summarised in Table 6.1.

Table 6.1 Classification of common cash movements for the Statement of Cash Flows

Cash receipts	Cash payments
Operating activities	
Receipts from customers for services performed and sale of goods for cash	Payments to suppliers for purchases, e.g. purchase of goods, electricity, telephone and insurance
Receipts from other operating activities, e.g. rent received, dividends received, interest received and commission received	Payments to employees, e.g. wages Payments for other operating expenses, e.g. interest
Investing activities	
Proceeds from sales of long-term assets	Payments for long-term assets purchased
Sales of investments	Payments to purchase investments, e.g. shares
Receipt of loan repayment	Loans given to other parties
Financing activities	
Owner's investment in business	Owners' drawings or payment of dividends
Loans taken out	Repayment of loans

By way of further illustration, entries in the Cash at Bank account can be categorised to assist in the preparation of the Statement of Cash Flows.

The following is a Cash at Bank account in columnar format for Janis Jym, a personal trainer:

Ledger of Janis Jym					
Cash at Bank				No 3103	
Date	Particulars	Debit	Credit	Balance	
		\$	\$	\$	
Aug 1	Capital	10 000		10 000 Dr	Financing
2	Service Fees	100		10 100 Dr	Operating
2	Prepaid Insurance		200	9 900 Dr	Operating
4	Loan	5 000		14 900 Dr	Financing
6	Equipment		2 000	12 900 Dr	Investing
14	Rates		500	12 400 Dr	Operating
20	Shares in XYZ Ltd		5 000	7 400 Dr	Investing
25	Drawings		1 000	6 400 Dr	Financing
27	Service Fees	200		6 600 Dr	Operating
28	Advertising		300	6 300 Dr	Operating
31	Dividend from Shares	150		6 450 Dr	Operating

If this were shown in T form, the ledger would appear as follows:

Cash at Bank							No 3103
	Date	Particulars	Amount	Date	Particulars	Amount	
			\$			\$	
Financing	Aug 1	Capital	10 000	Aug 2	Prepaid Insurance	200	Operating
Operating	2	Service Fees	100	6	Equipment	2 000	Investing
Financing	4	Loan	5 000	14	Rates	500	Operating
Operating	27	Service Fees	200	20	Shares in XYZ Ltd	5 000	Investing
Operating	31	Dividend from Shares	150	25	Drawings	1 000	Financing
				28	Advertising	300	Operating
				31	Balance c/d	6 450	
			<u>\$15 450</u>			<u>\$15 450</u>	
	Sept 1	Balance b/d	6 450				

Check for understanding

- 6.10 **Explain** the main operating, financing and investing activities.
- 6.11 **Categorise** the transactions in the following ledger account into either:
- Operating
 - Financing
 - Investing.

Cash at Bank				No 3103
Date	Particulars	Debit	Credit	Balance
		\$	\$	\$
June 1	Capital	20 000		20 000 Dr
3	Wages		1 600	18 400 Dr
6	Dividend from Shares	1 900		20 300 Dr
10	Service Fees	2 100		22 400 Dr
17	Wages		1 600	20 800 Dr
23	Shares in Shell Oil Co		2 000	18 800 Dr
30	Drawings		500	18 300 Dr

Presentation of the Statement of Cash Flows

Now that you can identify the types of cash flow in the Cash at Bank account, we can prepare a Statement of Cash Flows. You should note that the descriptions in the statement are dictated by the accounting standard, and may be different from the descriptions in the Cash at Bank account, which is normally used in double entry.

The following is a model of a Statement of Cash Flows, which will assist you in its preparation. You should try to understand its structure and why each item appears where it does. When completing the statement, endeavour to complete each line of the statement in the order outlined. Remember that different businesses may change this structure slightly to suit their own particular situations. Many businesses and accountants do not separate inflows and outflows in each section. They show outflows in brackets.

XYZ Industries			
Statement of Cash Flows for the period ended ...			
	\$	\$	\$
Cash flows from operating activities			
<i>Inflows</i>			
Receipts from customers	x		
Dividends received	x		
Interest received	x		
Other operating revenue	<u>x</u>	x	
<i>Outflows</i>			
Payments to suppliers for purchases	x		
Payments to employees	x		
Interest paid	x		
Payments for other operating expenses	<u>x</u>	<u>x</u>	
Net cash from operating activities²			x
Cash flows from investing activities			
<i>Inflows</i>			
Proceeds from sale of long-term assets and other investments	<u>x</u>	x	
<i>Outflows</i>			
Payments for long-term assets and other investments	<u>x</u>	<u>x</u>	
Net cash used in investing activities²			(x)
Cash flows from financing activities			
<i>Inflows</i>			
Proceeds from capital contributions	x		
Proceeds from borrowings	<u>x</u>	<u>x</u>	
<i>Outflows</i>			
Repayment of borrowings	x		
Payment of drawings	<u>x</u>	<u>x</u>	
Net cash used in financing activities²			<u>(x)</u>
Net increase (decrease) in cash held			x
Cash at beginning of reporting period			<u>x</u>
Cash at end of reporting period			<u><u>x</u></u>

2 Cash can be either 'from' or 'used in' each of the three types of activities, depending on whether inflows or outflows are higher.

Using the Cash at Bank account for Janis Jym shown on page 236, the following Statement of Cash Flows is presented.

Janis Jym			
Statement of Cash Flows for the month ended 31 August			
	\$	\$	\$
Cash flows from operating activities			
<i>Inflows</i>			
Service fees	300		
Dividends from shares	<u>150</u>	450	
<i>Outflows</i>			
Insurance	200		
Rates	500		
Advertising	<u>300</u>	<u>1000</u>	
Net cash used in operating activities			(550)
Cash flows from investing activities			
<i>Outflows</i>			
Office equipment purchases	2 000		
Shares in XYZ Ltd	<u>5 000</u>	<u>7 000</u>	
Net cash used in investing activities			(7 000)
Cash flows from financing activities			
<i>Inflows</i>			
Capital	10 000		
Proceeds from bank loan	<u>5 000</u>	15 000	
<i>Outflows</i>			
Drawings	<u>1 000</u>	<u>1 000</u>	
Net cash from financing activities			<u>14 000</u>
Net increase in cash held			6 450
Cash at beginning of year			0
Cash at end of year			<u><u>\$6 450</u></u>

Interesting accounting fact

Did you know?

When was decimal currency introduced into Australia?

On ... 14 February 1966, Australia introduced decimal notes and coins, marking the end of its British-style currency system based on pounds, shillings and pence.

In the lead up to the introduction of decimal currency there was a concerted program to educate the public. This included extensive media coverage, including the famous 'Dollar Bill' campaign.

Source: 'On this day: Australia goes decimal', The Perth Mint, 2012, <http://blog.perthmint.com.au/>

Check for understanding

- 6.12 Using the Cash at Bank account in Question 6.11, **prepare** a Statement of Cash Flows.
- 6.13 From the following Cash at Bank account, **prepare** a Statement of Cash Flows.

Cash at Bank				No 3103
Date	Particulars	Debit	Credit	Balance
		\$	\$	\$
June 1	Capital	100 000		100 000 Dr
3	Rent		10 000	90 000 Dr
16	Interest from Investment	500		90 500 Dr
10	Service Fees	20 000		110 500 Dr
16	Wages		1 500	109 000 Dr
23	Shares in BHP		20 000	89 000 Dr
30	Drawings		500	88 500 Dr
	Service Fees	8 000		96 500 Dr
	Wages		1 500	95 000 Dr

Combined illustrative example of the Statement of Profit or Loss, Statement of Financial Position and Statement of Cash Flows

In Chapter 4 we prepared a comprehensive illustrative example that showed a transaction listing for June, and then showed the general journal, ledger and trial balance. We are now going to use this same example for Artiste Perfection and prepare the end of period statements: the Statement of Profit or Loss, the Statement of Financial Position and the Statement of Cash Flows. For ease of illustration, the Cash at Bank account from page 107 and the trial balance from page 108 are presented again. Let us also assume that the accountant has compared the Cash at Bank account with the items in the 30 June 2026 Bank Statement and it is revealed:

- the bank does not have a record of the drawings of \$4200
- the credit balance in the bank statement is \$22 953.

Cash at Bank				No 3103			
June 1	Capital	GJ1	80 000	June 1	Furniture	GJ1	2 300
8	Service Fees Revenue	GJ1	2 240	1	Motor Vehicle	GJ1	10 700
16	Service Fees Revenue	GJ2	2 130	1	Equipment	GJ1	17 000
22	Service Fees Revenue	GJ2	2 570	1	Prepaid Insurance	GJ1	1 200
26	Service Fees Revenue	GJ2	3 710	2	Supplies	GJ1	700
				2	Rent Expense	GJ1	800
				2	Telephone	GJ1	95
				2	Electricity	GJ1	85
				4	Advertising	GJ1	650
				4	Office Expenses	GJ1	375
				4	Cash Investment	GJ1	30 000
				11	Wages	GJ2	1 260
				18	Wages	GJ2	1 260
				25	Wages	GJ2	1 260
				29	Drawings	GJ2	4 200
				30	Bank Charges	GJ2	12

Artiste Perfection
Trial Balance as at 30 June 2026

Account no	Account	Debit \$	Credit \$
1102	Service Fees Revenue		15 870
2201	Supplies Expense	230	
2301	Advertising	650	
2407	Electricity	85	
2408	Insurance	100	
2410	Office Expenses	375	
2414	Rent Expense	800	
2419	Telephone and Internet Expense	95	
2421	Wages and Salaries	3 780	
2502	Bank Charges	12	
3103	Cash at Bank	18 753	
3104.1	Adam Jones	5 220	
3107	Supplies	3 270	
3109	Prepaid Insurance	1 100	
3205	Cash Investment	30 000	
3301	Furniture	2 300	
3303	Motor Vehicles	10 700	
3304	Equipment	17 000	
4101.1	Ejang Supply Co		2 800
5101	Capital		80 000
5101A	Drawings	4 200	
		<u>4 200</u>	
		<u>\$98 670</u>	<u>\$98 670</u>

The reports prepared from this information are as follows:

Artiste Perfection		
Statement of Profit or Loss for the month ending 30 June 2026		
	\$	\$
Revenue		
Service Fees Revenue		15 870
Less Expenses		
Supplies Expense	230	
Advertising	650	
Electricity	85	
Insurance	100	
Office Expenses	375	
Rent Expense	800	
Telephone and Internet Expense	95	
Wages and Salaries	3780	
Bank Charges	<u>12</u>	<u>6 127</u>
Net profit		<u><u>\$9 743</u></u>

Artiste Perfection		
Statement of Financial Position as at 30 June 2026		
	\$	\$
Assets		
Cash at Bank	18 753	
Accounts Receivable	5 220	
Supplies	3 270	
Prepaid Insurance	1 100	
Cash Investment	30 000	
Furniture	2 300	
Motor Vehicles	10 700	
Equipment	<u>17 000</u>	88 343
Less Liabilities		
Accounts Payable		<u>2 800</u>
Net assets		<u><u>\$85 543</u></u>
Owner's Equity		
Capital (1 June 2026)	80 000	
Add Profit	<u>9 743</u>	
	89 743	
Less Drawings	<u>4 200</u>	<u><u>\$85 543</u></u>

Artiste Perfection
Statement of Cash Flows for the month ending 30 June 2026

	\$	\$	\$
Cash flows from operating activities			
<i>Inflows</i>			
Service Fees		10 650	
<i>Outflows</i>			
Prepaid Insurance	1 200		
Supplies	700		
Rent Expense	800		
Telephone	95		
Electricity	85		
Advertising	650		
Office Expenses	375		
Wages and Salaries	3 780		
Bank Charges	<u>12</u>	<u>(7 697)</u>	
Net cash from operating activities			2 953
Cash flows from investing activities			
<i>Outflows</i>			
Furniture		2 300	
Motor Vehicle		10 700	
Equipment		<u>17 000</u>	
Net cash used in investing activities			(30 000)
Cash flows from financing activities			
<i>Inflows</i>			
Capital		80 000	
<i>Outflows</i>			
Drawings		<u>(4 200)</u>	
Net cash from financing activities			<u>75 800</u>
Net increase in cash held			48 753
Cash at beginning			<u>0</u>
Cash at end			<u><u>\$48 753</u></u>

Note: Cash at end is made up of Cash at Bank, \$18 753, and Cash Investment, \$30 000.

Artiste Perfection
Bank Reconciliation Statement as at 30 June 2026

Credit balance as per bank statement	22 953
Less outstanding payments	<u>4 200</u>
Debit balance as per Cash at Bank account	<u>\$18 753</u>

There are a number of points that are worthy of mention about this combined illustrative example.

Looking at the Statement of Profit or Loss:

- It appears as if the business has made a good profit of \$9743 for the month. However, there may be changes around the corner. What would be the implication if employees were awarded a 5 per cent wage increase and electricity charges increased by 10 per cent in the next month? What impact would this have on the firm's profitability?

Looking at the Statement of Financial Position:

- If the business wanted to borrow \$20 000 next month for a new truck, what effect would this have on the financial position?
- Are the suppliers (accounts payable) providing purchases on time with appropriate payment terms? Should new suppliers be investigated?

Looking at the Statement of Cash Flows:

- The cash at the end is cash and cash equivalents (i.e. Cash at Bank \$18 753 and Cash Investment \$30 000).
- The net cash from operating activities is \$2953, while the net profit is \$9743. It is interesting to check why there is a difference between these two figures. Essentially, it is because there are accrual items (i.e. non-cash items) that are included in the net profit figure but not in the cash flows from operations. These figures are the increases over the month in accounts receivable (\$5220), in accounts payable (\$2800), in supplies (\$3270) and in prepaid insurance (\$1100). When these amounts are adjusted against net profit, the net cash from operating activities of \$2953 is obtained. Using the accounts receivable as an example, under accrual accounting, service fees revenue included \$5220 of fees earned on credit and so that is included in the profit figure. However, we received no cash and so it was not included in the net cash from operating activities. If the accounts receivable do not pay us, then there is less cash to meet our obligations and our financial security is put at risk. That is why it is important that we only sell to people we know are going to pay us. A similar reasoning signifying the difference between profit and cash can be applied to all the items mentioned here.

In summary, while there was a profit of \$9743, the net cash from operating activities for the same period was only \$2953. It is vital that you understand the difference between cash and profit. They do not mean the same thing. Over the long term, the net cash inflow from operations must continue to rise or the business will have no money to pay its bills and invest in the future.

Real-world application



Statement of Cash Flows

When the owners of a business approach an investor or bank to commit funds to their business, what information does the investor require of the business? Follow the weblink to watch a video detailing one person's interpretation of what is required. Can you think of some other information that you would take to a lending institution?



Weblink
Statement of
Cash Flows

It is important to understand that the illustrative example you have just studied is very simplified. It has been designed to bring out the major elements of accounting so you have a broad understanding of the processes involved in accounting for a business. However, over the remainder of the book, we are going to expand your understanding of the term ‘accrual accounting’. Just as a pointer to where this is leading, go back to page 107 in Chapter 4 and think again about the following transactions:

- On 26 June, we received \$3710 for client work. What do you think should happen if it was revealed that as part of that \$3710, a customer had paid us \$530 in advance for a job to be started and completed in the week of 9 July 2026?
- If you look at the dates the wages were paid, you will see that \$1260 has been paid on 11, 18 and 25 June. When is the next payment due? Do you think that when the payment is made on 2 July, the amount of \$1260 belongs to the period ended 30 June or the period ended 31 July?
- On 4 June we also transferred \$30 000 to an investment account to earn some interest. At 30 June, do you think the money has earned interest? Have we recorded any interest? Even though we have not received the money, should the exact amount of interest revenue be brought to account at 30 June?

In all these instances, questions are raised about the amounts that are actually in the accounts and what amounts should be in the accounts to accurately reflect what has happened in the accounting period. These adjustments are called **balance day adjustments**. You have already been doing two balance day adjustments in your recording so far:

- The first relates to Supplies – when purchased they are treated as an asset. However, when they are used in the performance of the service (e.g. a plumber using some glue and washers), the asset is reduced and an expense is brought to account. This can be done at the time the service is performed or at the end of the month. Look at the supplies used transaction for \$230 on 30 June on page 105 and you will see we have been bringing them to account at the end of the month.
- The second transaction is Insurance – when purchased on 1 June it is treated as an asset of \$1200. It is a future economic benefit for the next 12 months and is called Prepaid Insurance. This means that every month, Prepaid Insurance must be reduced and the expense brought to account. This is why on 30 June on page 105 you put through a transaction using up one month’s worth of insurance, which is \$100.

Other balance day adjustments relate to depreciation on the furniture, motor vehicles and equipment that were purchased on 1 June. These adjustments will be covered in Unit 3.

Balance day adjustments

We have previously seen that under the accounting period concept, the life of the business may be broken down into arbitrary periods in order for the owners and managers of the business to determine how the business is progressing. Usually, once a year, at the end of the statutory financial year, the business needs to report the results of its operations to its external stakeholders – its owners and the taxation authorities.

Unfortunately, many business transactions do not fit neatly into the statutory financial year. Business transactions flow continuously through the life of the business, and are interrupted by the end of the accounting period. Therefore, adjustments must be made to recorded figures at the end of the accounting period, on a day usually called the balance day. The most common financial periods are from 1 July in one year to 30 June in the following year, or from 1 January to 31 December in the same year.

Adjustments to the records made at the end of an accounting period (end of month or end of year) are called **balance day adjustments**. The aim of these adjustments is to calculate a profit figure that is as accurate as possible for every accounting period. They must be made *before* preparing a Statement of Profit or Loss, a Statement of Financial Position and a Statement of Cash Flows.

Balance day adjustments are entries made at balance day in order to accurately show the revenues and expenses so that profit can be determined, and to bring into account assets and liabilities not previously recorded.

Therefore, our accounting process now includes balance day adjustments as step 4, as shown in Figure 6.1, and becomes:

- 1 Prepare or collect source documents to verify that transactions have occurred.
- 2 Analyse transactions into their debit and credit elements, and enter into a journal.
- 3 Post the debit and credit elements to appropriate ledger accounts, and prepare a trial balance.
- 4 **Record and post balance day adjustments.**
- 5 Prepare end of period (month/year) financial reports.

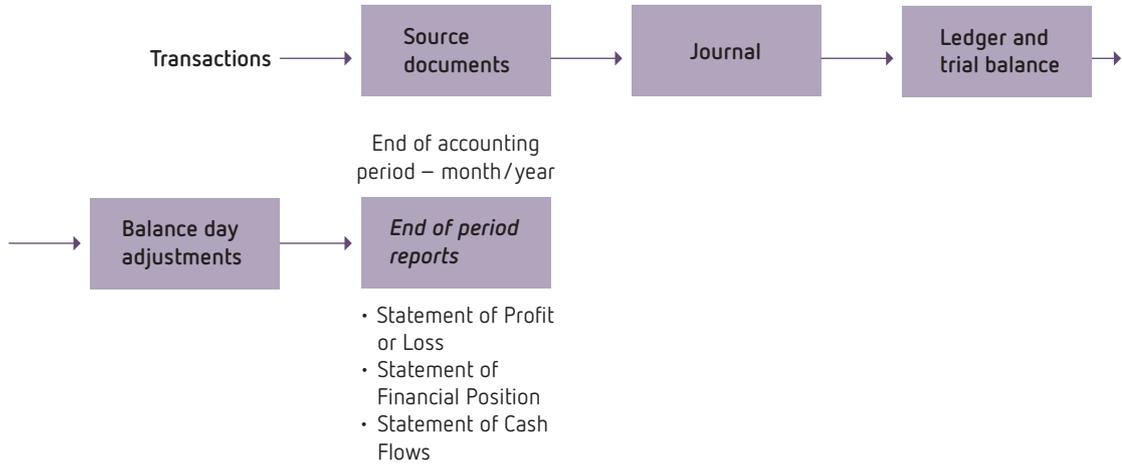


Figure 6.1 Accounting process to end of period reports

Balance day adjustments are needed because transactions do not fit neatly into accounting periods. The balance day adjustments covered here will fall into one of two categories:

- accruals
- prepayments.

Accruals

Accrued expenses

Accrued expenses are expenses incurred in the current accounting period but not yet paid or recorded.

Accrued expenses are amounts owed by the business and are therefore liabilities.

Assume that wages are paid every week and that an entry is made in the journal and then posted to the Wages and Salaries account in the ledger. The ledger account reveals:

				Wages and Salaries	No 2421
				\$	\$
June 6	Cash	GJ11	1 000		
13	Cash	GJ18	1 000		
20	Cash	GJ27	1 000		
27	Cash	GJ29	1 000		

Balance day is 30 June, which is a Friday, and employees are paid every Tuesday. The total wages bill is \$200 a day. You should note that wages are calculated on a five-day week (i.e. there is no payment for Saturday or Sunday). The next payday is 4 July.

On balance day (30 June) it is obvious that the employees have worked three extra days. They will not be paid for these days until the next payday, 4 July, which falls outside this accounting period.

However, it is necessary that the Wages and Salaries account include the wages for these three days because these were expenses incurred in earning the revenue for the period. This can be shown using a time diagram (see Figure 6.2).

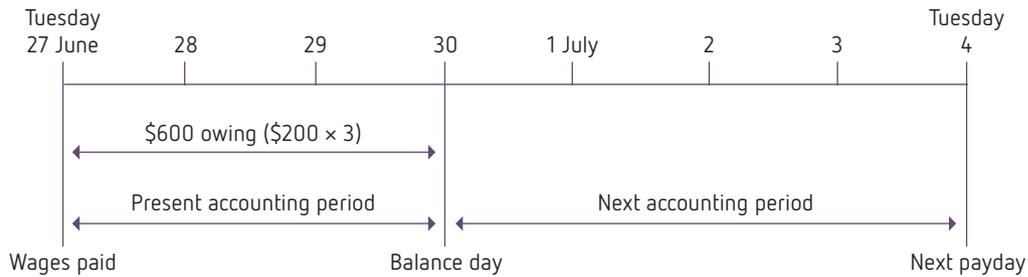


Figure 6.2 Time diagram showing accrued expenses

The general journal entry necessary to incorporate these wages into the record is:

General Journal					P31
Date	Particulars	Ref	Dr \$	Cr \$	
June 30	Wages and Salaries	2421	600		
	Accrued Expenses	4104		600	
	(Wages adjustment at 30 June, three days by \$200 per day)				

The effect of this entry is twofold:

- to increase the expense account for Wages and Salaries by \$600 to \$4600 because employees have worked for these three days
- to record the fact that at balance day the organisation has a liability of \$600 for these wages because they have not yet been paid, but are owed at balance day.

The ledger accounts now appear as:

Wages and Salaries				No 2421
			\$	\$
June 6	Cash	GJ11	1 000	
13	Cash	GJ18	1 000	
20	Cash	GJ27	1 000	
27	Cash	GJ29	1 000	
30	Accrued Expenses	GJ31	600	
Accrued Expenses				No 4104
			\$	\$
June 30	Wages and Salaries	GJ31		600

Note again that this balance day adjustment (like all others) is necessary because the payment of wages did not coincide with the accounting period.

Individual liability accounts (such as Accrued Wages and Salaries) could be opened if desired, instead of putting all amounts into an Accrued Expenses account.

Accrued revenues

Accrued revenues are revenues that have been earned in the current accounting period but have not yet been received or recorded.

Accrued revenues are amounts owing to the business and are therefore assets.

Assume that we regularly work on a commission basis and are paid fortnightly. Our ledger account reveals:

Commission Revenue				No 1103
				\$
	June 10	Cash	GJ17	100
	24	Cash	GJ28	200

At 30 June an extra \$50 had been earned but it had not yet been received and entered into the records. The Commission Revenue account as it stands does not reflect the full amount of commission earned for the period. This can also be shown using a time diagram (see Figure 6.3).

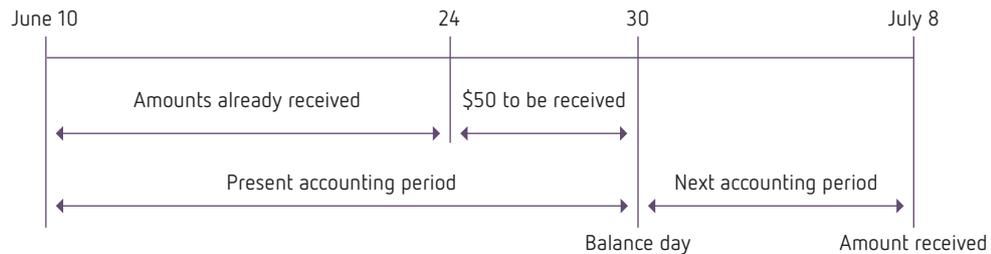


Figure 6.3 Time diagram showing accrued revenues

To record this extra amount, it is necessary to make the following general journal entry:

General Journal					P31
Date	Particulars	Ref	Dr \$	Cr \$	
June 30	Accrued Revenues Commission Revenue (Commission earned at 30 June but not yet received)	3107 1103	50		50

The effect of this entry is twofold:

- to increase the revenue account for Commission Revenue by \$50 to \$350 because we have earned this amount
- to record the fact that at balance day the organisation has an asset in the form of money owing for work performed, but which has not yet been received.

Because one month's insurance is used up every month, an entry will be recorded at the end of each month for \$150 worth of insurance. To record the expired insurance for the month of June, the following entry will be processed.

General Journal				
Date	Particulars	Ref	Dr \$	P 31 Cr \$
June 30	Insurance	2408	150	
	Prepaid Insurance	3108		150
	(Expired insurance for one month)			

The effect of this entry is twofold:

- to increase the expense account (Insurance) by \$150 to its 'correct' value because this is the expense for the period
- to reduce the asset account (Prepaid Insurance) by \$150 as one month's insurance has been used.

It is an asset because at this point in time the balance of the account is owed to the business.

Note that the \$1800 is already in the records and we are merely apportioning it to various accounting periods each month. The ledger accounts now appear as:

Insurance				No 2408
			\$	
Feb 28	Prepaid Insurance	GJ6	150	
Mar 31	Prepaid Insurance	GJ10	150	
Apr 30	Prepaid Insurance	GJ15	150	
May 31	Prepaid Insurance	GJ26	150	
June 30	Prepaid Insurance	GJ31	150	
Prepaid Insurance				No 3109
			\$	\$
Feb 1	Cash at Bank	GJ1	1800	Feb 28 Insurance GJ6 150
				Mar 31 Insurance GJ10 150
				Apr 30 Insurance GJ15 150
				May 31 Insurance GJ26 150
				June 30 Insurance GJ31 150

Alternatively, if yearly reporting is done, one entry would be made on 30 June debiting Insurance and crediting Prepaid Insurance for \$750.

Prepaid advertising, where a payment is made for an advertising campaign for a period of time, say three months, is another form of prepayment. Similar to insurance, when the payment is made, it would be recorded in an asset account called Prepaid Advertising. When each month of the advertising is used up, the expense account Advertising will be debited and the asset account Prepaid Advertising will be credited.

A further type of prepayment is stocks of Supplies and Stationery. Up to this point, we have always recorded Supplies as an asset; when the supplies are used, they are transferred to the Supplies Expense account. The question to ask is: at the end of the month or year, how do we determine what supplies have been used (recorded in the expense account) and what supplies are still on hand (recorded in the asset Supplies account)?

Businesses commonly use the **periodic inventory system** in this situation. This system assumes that at any point in time, a stocktake is performed and the value of the supplies on hand is calculated. In order to determine the supplies used, the following calculation is performed:

Cost of supplies used = Opening supplies on hand + Purchases of supplies – Closing supplies on hand

This concept can be shown using ledger accounts. Let's say that the opening balance of supplies on hand at 1 May was \$4300 and purchases of supplies during May was \$7800. The ledger account would appear as follows:

Supplies				No 3107
			\$	
May 1	Balance	b/d	4 300	
31	Cash/Accts Payable		7 800	

This means that during the month, there were \$12 100 worth of supplies available to be used. If we do a stocktake and calculate that there are \$5800 worth of supplies on hand, the ledger account would appear as follows:

Supplies				No 3107
May 1	Balance b/d	4 300	May 31	
31	Cash/Accts Payable	7 800	Balance c/d	5 800
		<u>\$12 100</u>		<u>5 800</u>
June 1	Balance b/d	5 800		<u>\$12 100</u>

The closing balance of \$5800 is an asset and so must appear as a debit balance as above. If we know the opening balance, the purchases and the closing balance, then whatever is left must be the supplies that are used. This is often referred to as the 'hole in the ledger account', indicated by the purple circle above. The two ledger accounts would appear as follows:

Supplies Expense				No 2201
May 31	Supplies	GJ78	6 300	
Supplies				No 3107
May 1	Balance b/d	4 300	May 31	Supplies Expense GJ78 6 300
31	Cash/Accts Payable	7 800	Balance c/d	5 800
		<u>\$12 100</u>		<u>5 800</u>
June 1	Balance b/d	5 800		<u>\$12 100</u>

This entry debiting Supplies Expense and crediting Supplies for \$6300 is referred to as a **balance day adjustment**. You have been recording this entry since Chapter 2.

Let's now move to the end of the following month – June, which is the end of the financial year. Assume there have been \$6000 worth of supplies purchased and a stocktake reveals \$4600 worth of supplies on hand. The balance day adjustment for 30 June and the resulting ledger accounts would appear as follows:

General Journal					P 92
Date	Particulars	Ref	Dr	Cr	
			\$	\$	
June 30	Supplies Expense Supplies (Supplies used for month)	2201 3107	7 200	7 200	

Supplies Expense				No 2201					
May	31	Supplies	GJ78	6 300					
June	30	Supplies	GJ92	7 200					
Supplies				No 3107					
May	1	Balance b/d		4 300	May	31	Supplies Expense	GJ78	6 300
	31	Cash/Accts Payable		7 800			Balance c/d		5 800
				<u>\$12 100</u>					<u>\$12 100</u>
June	1	Balance b/d		5 800	June	30	Supplies Expense	GJ92	7 200
	30	Cash/Accts Payable		6 000			Balance c/d		4 600
				<u>\$11 800</u>					<u>\$11 800</u>
July	1	Balance b/d		4 600					

A similar process to that used for supplies can be used for stationery.

Unearned revenues

Unearned revenues or revenues received in advance are revenues that have been received and recorded in the current accounting period but that will not be earned until a future accounting period.

Unearned revenues are amounts owed by the business and are therefore **liabilities**.

Assume that the business regularly rents out part of its building. Rent is normally received weekly in advance from the tenants.

After entry into the journal, the Rent Revenue account would appear as:

Rent Revenue				No 1106	
					\$
	June	7	Cash	GJ11	630
		14	Cash	GJ18	630
		21	Cash	GJ20	630
		28	Cash	GJ26	630

The \$630 received on 28 June is for the next seven days. This can be shown using a time diagram (see Figure 6.5).

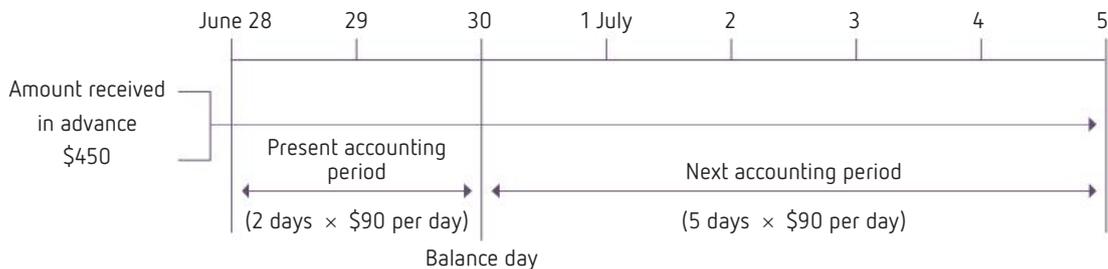


Figure 6.5 Time diagram showing unearned revenues

The \$450 must be removed from the Rent Revenue account so that it does not overstate the revenue for this period. The necessary general journal entry is:

General Journal					P31
Date	Particulars	Ref	Dr	Cr	
			\$	\$	
June 30	Rent Revenue	1106	450		
	Unearned Revenues	4105		450	
	(Recording \$450 of rent received in advance)				

The effect of this entry is twofold:

- to reduce the revenue account (Rent Revenue) so that it shows only the amounts that have been earned (\$2070). Only revenue that has been earned in this period should be recognised in the ledger accounts at this point in time
- to record that at balance day the organisation has a liability for the revenue it has received but not yet earned (\$450). It is a liability because at this point in time the amount is owed to the tenants.

The ledger accounts now appear as:

Rent Revenue				No 1106			
				\$			
June 30	Unearned Revenues	GJ31	450	June 7	Cash	GJ11	630
				14	Cash	GJ18	630
				21	Cash	GJ20	630
				28	Cash	GJ26	630
Unearned Revenues				No 4105			
				\$			
				June 30	Rent Revenue	GJ31	450

Check for understanding

- 6.14 **Explain** why accrued revenues and prepaid expenses are assets.
- 6.15 **Explain** why accrued expenses and unearned revenues are liabilities.
- 6.16 A business balances its accounts on 30 June. **Analyse** the following situations and **prepare** balance day adjustments to effect these changes
- Rent expense has been prepaid for one month at \$200 per month. The rent had been recorded as an asset.
 - Insurance expense at \$500 per month. The insurance had been recorded as an asset.
 - Commission revenue of \$400 is owing.
 - Wages of \$80 are owing at balance date.
- 6.17 A business balances its accounts on 31 December. **Analyse** the following situations and **prepare** the balance day adjustments to effect these changes:
- The trial balance shows prepaid advertising as \$10 000. Of this amount, \$1500 is consumed.
 - Sales salaries are \$2000 every five-day week and are paid on Tuesday. Balance day is Thursday.
 - Interest is owing on government bonds for one month. The business has \$10 000 invested in bonds and the interest rate is 12 per cent per annum.
 - The business sublets part of its premises and receives rent. Rent is payable one month in advance and is due on the last day of each month and is recorded as revenue. Rent is \$620 per month.

The adjusted trial balance and end of year financial statements for a service organisation

In Chapter 4 and earlier in this chapter, we presented the illustrative example of Artiste Perfection and showed the full accounting process and the determination of the Statement of Profit or Loss, the Statement of Financial Position and the Statement of Cash Flows, assuming that we were reporting to management.

Now, we want to continue this example, but this time assume that it is the end of the financial year and we need to report to our stakeholders; that is, to prepare the Statement of Profit or Loss and the Statement of Financial Position using full accrual accounting with all relevant balance day adjustments. In terms of the accounting process, this is the completion of step 5 as shown on page 246; that is:

- 1 Prepare or collect source documents to verify that transactions have occurred.
- 2 Analyse transactions into their debit and credit elements, and enter into a journal.
- 3 Post the debit and credit elements to appropriate ledger accounts, and prepare a trial balance.
- 4 Record and post balance day adjustments.
- 5 Prepare end of period (month/year) financial reports.

Preparation of an adjusted trial balance

The first step in presenting the end of financial year reports (as we saw in the previous section) is to journalise the balance day adjustments and then prepare an adjusted trial balance.

Let's resume the example for Artiste Perfection discussed on page 245 and assume the following information about the balance day adjustments.

- The supplies used at the end of June amount to \$230 (already recorded).
- Insurance for the month is \$100 (already recorded).
- Wages owing at year end are \$1260.
- Accrued interest owing to business on cash investment is \$50.
- On 30 June a customer paid \$530 in advance for a job we will not commence until next financial year.

Artiste Perfection			
Trial Balance as at 30 June 2026			
Account no	Account	Dr \$	Cr \$
1102	Service Fees Revenue		15 870
2201	Supplies Expense	230	
2301	Advertising	650	
2407	Electricity	85	
2408	Insurance	100	
2410	Office Expenses	375	
2414	Rent Expense	800	
2419	Telephone and Internet Expense	95	
2421	Wages and Salaries	3 780	
2502	Bank Charges	12	
3103	Cash at Bank	18 753	
3104.1	Adam Jones	5 220	
3107	Supplies	3 270	
3109	Prepaid Insurance	1 100	
3205	Cash Investment	30 000	
3301	Furniture	2 300	
3303	Motor Vehicles	10 700	
3304	Equipment	17 000	
4101.1	Ejang Supply Co		2 800
5101	Capital		80 000
5101A	Drawings	4 200	
		<u>\$98 670</u>	<u>\$98 670</u>

Note that we have four types of balance day adjustments that we need to adjust the trial balance for:

- Accrued expenses – Wages of \$1260 that we need to adjust for **(1)**.
- Accrued revenues – Interest of \$50 that we need to adjust for **(2)**.
- Prepaid expenses – Supplies and Insurance, and both entries have already been made.
- Unearned revenues – Service Fee Revenue of \$530 that we need to adjust for **(3)**.

You can see that, effectively, we journalise these entries in the columns and then obtain the final figures in the 'After Adjustment' column.

Artiste Perfection							
Trial Balances as at 30 June 2026							
Account no	Account	Before Adjustment		Adjustment		After Adjustment	
		Dr \$	Cr \$	Dr \$	Cr \$	Dr \$	Cr \$
1102	Service Fees Revenue		15 870	530 (3)			15 340
1105	Interest Revenue				50 (2)		50
2201	Supplies Expense	230				230	
2301	Advertising	650				650	
2407	Electricity	85				85	
2408	Insurance	100				100	
2410	Office Expenses	375				375	
2414	Rent Expense	800				800	
2419	Telephone and Internet Expense	95				95	
2421	Wages and Salaries	3 780		1 260 (1)		5 040	
2502	Bank Charges	12				12	
3103	Cash at Bank	18 753				18 753	
3104.1	Adam Jones	5 220				5 220	
3107	Supplies	3 270				3 270	
3108	Accrued Revenues			50 (2)		50	
3109	Prepaid Insurance	1 100				1 100	
3205	Cash Investment	30 000				30 000	
3301	Furniture	2 300				2 300	
3303	Motor Vehicles	10 700				10 700	
3304	Equipment	17 000				17 000	
4101.1	Ejang Supply Co		2 800				2 800
4104	Accrued Expenses				1 260 (1)		1 260
4105	Unearned Revenues				530 (3)		530
5101	Capital		80 000				80 000
5101A	Drawings	4 200				4 200	
		<u>\$98 670</u>	<u>\$98 670</u>	<u>\$1 840</u>	<u>\$1 840</u>	<u>\$99 980</u>	<u>\$99 980</u>

Preparation of the financial statements

Now that we have the up-to-date figures for each item (which can be displayed in the form of an adjusted trial balance, as shown here), we can prepare the Statement of Profit or Loss and the Statement of Financial Position.

Artiste Perfection			
Adjusted Trial Balance as at 30 June 2026			
Account no	Account	Dr \$	Cr \$
1102	Service Fees Revenue		15 340
1105	Interest Revenue		50
2201	Supplies Expense	230	
2301	Advertising	650	
2407	Electricity	85	
2408	Insurance	100	
2410	Office Expenses	375	
2414	Rent Expense	800	
2419	Telephone and Internet Expense	95	
2421	Wages and Salaries	5 040	
2502	Bank Charges	12	
3103	Cash at Bank	18 753	
3104.1	Adam Jones	5 220	
3107	Supplies	3 270	
3108	Accrued Revenues	50	
3109	Prepaid Insurance	1 100	
3205	Cash Investment	30 000	
3301	Furniture	2 300	
3303	Motor Vehicles	10 700	
3304	Equipment	17 000	
4101.1	Ejang Supply Co		2 800
4104	Accrued Expenses		1 260
4105	Unearned Revenues		530
5101	Capital		80 000
5101A	Drawings	4 200	
		<u>\$99 980</u>	<u>\$99 980</u>

Artiste Perfection		
Statement of Profit or Loss for month ending 30 June 2026		
	\$	\$
Revenue		
Service Fees Revenue	15 340	
Interest revenue	<u>50</u>	15 390
Less Expenses		
Supplies Expense	230	
Advertising	650	
Electricity	85	
Insurance	100	
Office Expenses	375	
Rent Expense	800	
Telephone and Internet Expense	95	
Wages and Salaries	5 040	
Bank Charges	<u>12</u>	<u>7 387</u>
Net profit		<u><u>\$8 003</u></u>

Artiste Perfection		
Statement of Financial Position as at 30 June 2026		
	\$	\$
Assets		
Cash at Bank	18 753	
Accounts Receivable	5 220	
Supplies	3 270	
Accrued Revenues	50	
Prepaid Insurance	1 100	
Cash Investment	30 000	
Furniture	2 300	
Motor Vehicles	10 700	
Equipment	<u>17 000</u>	88 393
Less Liabilities		
Accounts Payable	2 800	
Accrued Expenses	1 260	
Unearned Revenues	<u>530</u>	<u>4 590</u>
Net assets		<u><u>\$83 803</u></u>
Owner's Equity		
Capital (1 June 2026)	80 000	
Add Profit	<u>8 003</u>	
	88 003	
Less Drawings	<u>4 200</u>	<u><u>\$83 803</u></u>

Now that we have completed the preparation of the Statement of Profit or Loss and the Statement of Financial Position for Artiste Perfection under accrual accounting, it is worth referring back to those same statements prepared under cash accounting on page 242 to truly appreciate the effect of balance day adjustments.

- The reported net profit under cash accounting is \$9743, whereas under accrual accounting it is \$8003. This change flows on to the recording of a different closing capital figure, from \$85 543 to \$83 803.
 - Individual revenue items have changed: Service Fees Revenue from \$15 870 to \$15 340; and Interest revenue from \$0 to \$50.
 - Individual expense items have changed: Wages and Salaries from \$3780 to \$5040.
 - New assets have been recorded: Accrued revenues \$50.
 - New liabilities have been recorded: Accrued expenses \$1260 and Unearned revenues \$530.
- The accrual accounting figures are a truer representation of the business activities for the financial year.

Check for understanding

6.18 **Analyse** the following trial balance and balance day adjustments for Platinum Painters.

Prepare:

- balance day adjustment journal entries
- a Statement of Profit or Loss for the year ended 30 June 2026
- a Statement of Financial Position as at 30 June 2026.

Platinum Painters				
Trial Balance as at 30 June 2026				
Account no	Account	Dr		Cr
		\$		\$
1102	Service Fees Revenue			30 000
2301	Advertising	1 000		
2408	Insurance	1 000		
2410	Office Expenses	800		
2419	Telephone and Internet Expense	200		
2421	Wages and Salaries	8 000		
2502	Bank Charges	12		
3103	Cash at Bank	20 000		
3104.1	F Wang	6 000		
3107	Supplies	4 000		
3109	Prepaid Insurance	2 000		
3205	Cash Investment	30 000		
3303	Motor Truck	20 000		
3304	Equipment	10 000		
4101.1	Webster Pty Ltd			2 800
5101	Capital			80 212
5101A	Drawings	10 000		
		<u>\$113 012</u>		<u>\$113 012</u>

- The supplies used by the end of June are \$500.
- Wages owing at year end are \$3000.
- Accrued interest owing to business on cash investment is \$50.
- On 26 June a customer paid \$750 in advance for a job we will not commence until next financial year.
- Advertising into July of \$600 has been prepaid.
- Insurance for month is \$150.

Closing entries

At the end of the financial year, the relevant accounts for that financial year must be closed and made ready for the next financial year. The closing of these accounts effectively entails the following steps:

- All revenue accounts will be closed to the Profit or Loss Summary account. After this is done, all revenue accounts will have a zero balance.
- All expense accounts will be closed to the Profit or Loss Summary account. After this is done, all expense accounts will have a zero balance.
- The resultant profit or loss in the Profit or Loss Summary account will be closed to the Capital account.
- The drawings for the financial period will be closed to the Capital account.

At this point, the balances in all the revenue, expense, profit or loss summary and drawings accounts are zero, ready to begin the new financial year. The Capital account summarises all these accounts for the year, showing the beginning balance plus any profit for the year (less any loss) minus any drawings, to give the final closing balance for the year.

The accounting process now becomes:

- 1 Prepare or collect source documents to verify that transactions have occurred.
- 2 Analyse transactions into their debit and credit elements, and enter into a journal.
- 3 Post the debit and credit elements to appropriate ledger accounts, and prepare a trial balance.
- 4 Record and post balance day adjustments.
- 5 Prepare end of period (month/year) financial reports.
- 6 Record and post closing entries at the end of the year.

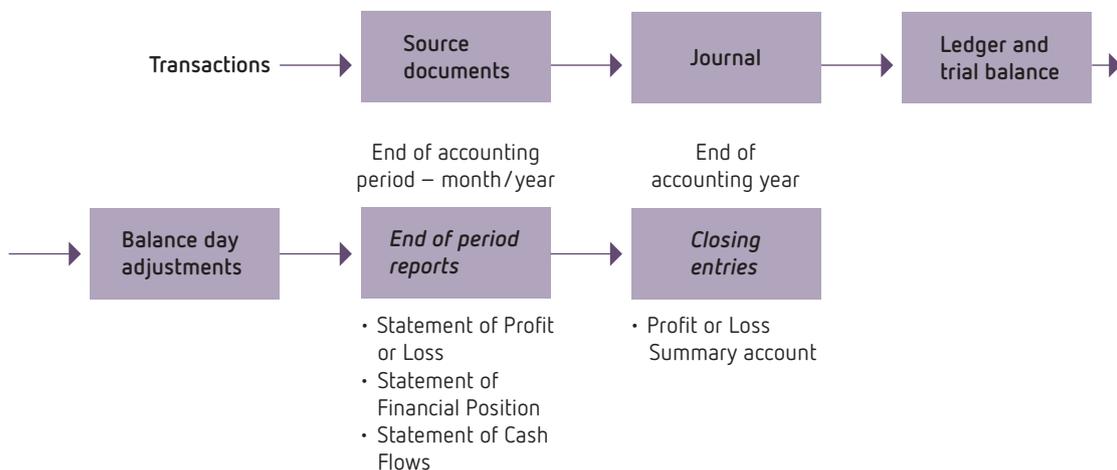


Figure 6.6 The accounting process to closing entries

Let us now illustrate step 6 using the Artiste Perfection example on page 257.

Artiste Perfection General Journal				
Date	Particulars	Ref	Dr \$	P2 Cr \$
2026 June 30	Service Fees Revenue	1102	15 340	
	Interest Revenue	1105	50	
	Profit or Loss Summary (Closing revenue accounts)	5102		15 390
	Profit or Loss Summary	5102	7 387	
	Supplies Expense	2201		230
	Advertising	2301		650
	Electricity	2407		85
	Insurance	2408		100
	Office Expenses	2410		375
	Rent Expense	2414		800
	Telephone and Internet Expense	2419		95
	Wages and Salaries	2421		5 040
	Bank Charges	2502		12
	(Closing expense accounts)			
	Profit or Loss Summary	5102	8 003	
	Capital	5101		8 003
	(Transfer profit to Capital account)			
	Capital	5101	4 200	
	Drawings	5101A		4 200
	(Close off drawings to Capital account)			

The Capital, Drawings and Profit or Loss Summary accounts after all balance day adjustments and closing entries will appear as follows:

Capital – M Huang				No 5101			
June 30	Drawings	GJ2	4 200	June 1	Cash at Bank	GJ1	80 000
	Balance c/d		83 803	30	Profit or Loss Summary	GJ2	8 003
			<u>\$88 003</u>				<u>\$88 003</u>
				July 1	Balance b/d		83 803
Drawings – M Huang				No 5101A			
June 29	Cash at Bank	GJ1	4 200	June 30	Capital	GJ2	4 200
			<u>\$4 200</u>				<u>\$4 200</u>
Profit or Loss Summary				No 5102			
June 30	Supplies Expense	GJ2	230	June 30	Service Fees Revenue	GJ2	15 340
	Advertising	GJ2	650		Interest Revenue	GJ2	50
	Electricity	GJ2	85				
	Insurance	GJ2	100				
	Office Expenses	GJ2	375				
	Rent Expense	GJ2	800				
	Telephone and Internet Expense	GJ2	95				
	Wages	GJ2	5 040				
	Bank Charges	GJ2	12				
	Capital (Net Profit)	GJ2	8 003				
			<u>\$15 390</u>				<u>\$15 390</u>

The items and amounts that appear in the Profit or Loss Summary account are the same as those previously prepared in the Statement of Profit or Loss (see page 258). The information is identical. However, it is important to note the differences between the two:

Profit or Loss Summary account

- is a profit-determining account prepared in the ledger
- forms part of the double-entry procedure
- is a ledger account
- is prepared only at the end of the accounting year
- contains information that is not classified

Statement of Profit or Loss

- is prepared outside the ledger
- does not form part of the double-entry procedure
- is a report
- may be prepared at any time
- contains information that is classified (see pages 258 and 277 and *Units 3 & 4*)

Check for understanding

- 6.19 **Explain** how a Profit or Loss Summary account is used by an entity to determine net profit or net loss.
- 6.20 **Analyse** the following information for a service entity and **prepare**:
- a closing entries necessary to prepare the Profit or Loss Summary account for G Porter
 - b each individual ledger account
 - c the Profit or Loss Summary account.

G Porter		
Trial Balance (extract) as at 30 June		
Account	Debit	Credit
	\$	\$
Service Fees Revenue		25 000
Rent Revenue		1 000
Wages and Salaries	8 000	
Supplies Expense	4 000	
Insurance	500	
Advertising	450	

- 6.21 **Analyse** the following information and **prepare**:
- a closing entries necessary to prepare the Profit or Loss Summary account for L Hall trading as Hall Services
 - b the Profit or Loss Summary account.

Hall Services		
Trial Balance (extract) as at 30 June		
Account	Debit	Credit
	\$	\$
Service Revenue		50 000
Advertising	1 500	
Insurance	250	
Sales Salaries	1 000	
Postage	1 000	
Interest Revenue		500

Reversing entries

The procedure for adjusting the figures for the **present** accounting period was shown on pages 245–253. A reversing entry needs to be made at the beginning of the **new** accounting period for two reasons:

- to ensure that ‘correct’ amounts for revenue and expenses are taken into account in the period to which they actually refer
- to cancel the temporary asset and liability accounts created on balance day by balance day adjustments (i.e. prepayments and accruals).

We will use the examples shown under ‘Balance day adjustments’ earlier in this chapter to illustrate reversing entries. You should refer to Figures 6.2 to 6.5 on pages 247–52 before considering each separate situation.

Accrued expenses

The ledger accounts appeared as:

Wages and Salaries					No 2421		
			\$			\$	
June 6	Cash	GJ11	1 000	June 30	Profit or Loss Summary	GJ32	4 600
13	Cash	GJ18	1 000				
20	Cash	GJ27	1 000				
27	Cash	GJ29	1 000				
30	Accrued Expenses	GJ31	600				
			<u>\$4 600</u>				<u>\$4 600</u>
Accrued Expenses					No 4104		
			\$				\$
June 30	Balance c/d		600	June 30	Wages and Salaries	GJ31	600
			<u>\$600</u>				<u>\$600</u>
				July 1	Balance b/d		600

When the wages (\$1000) are actually paid on 4 July, they are entered into the journal and posted to the ledger in the usual way. Note that if no other entries are made, this whole payment will appear as an expense of the new accounting period. Clearly, this is incorrect because part of the payment was an expense of the last period, and to include it in both periods would be double counting. Therefore, an adjustment is needed to ‘cancel’ this \$600 out of the Wages and Salaries account.

Further, when the wages are paid, the business no longer has a liability (accrued expenses), so this item should be removed from the records. The entry that accomplishes this is:

General Journal					P33
Date	Particulars	Ref	Dr	Cr	
			\$	\$	
July 1	Accrued Expenses	4104	600		
	Wages and Salaries	2421		600	
	(Reversing entry)				

This entry is often called a **reversing entry** because it is the reverse of the previous balance day adjustment. All reversing entries are made on the first day of the new accounting period.

The ledger accounts after the reversing entry and the cash payment appear as:

Wages and Salaries				No 2421			
			\$				\$
June 6	Cash	GJ11	1 000	June 30	Profit or Loss Summary	GJ32	4 600
13	Cash	GJ18	1 000				
20	Cash	GJ27	1 000				
27	Cash	GJ29	1 000				
30	Accrued Expenses	GJ31	600				
			<u>\$4 600</u>				<u>\$4 600</u>
July 4	Cash	GJ34	1 000	July 1	Accrued Expenses	GJ33	600
Accrued Expenses				No 4104			
			\$				\$
June 30	Balance c/d		600	June 30	Wages and Salaries	GJ31	600
			<u>\$600</u>				<u>\$600</u>
July 1	Wages and Salaries	GJ33	600	July 1	Balance b/d		600

Accrued revenues

After the reversing entry and the receipt of the commission on 10 July, the ledger accounts would appear as:

Commission Revenue				No 1103			
			\$				\$
June 30	Profit or Loss Summary	GJ32	350	June 10	Cash	GJ17	100
				24	Cash	GJ28	200
				30	Accrued Revenues	GJ31	50
			<u>\$350</u>				<u>\$350</u>
July 1	Accrued Revenues	GJ33	50	July 10	Cash	GJ35	200
Accrued Revenues				No 3107			
			\$				\$
June 30	Commission Revenue	GJ31	50	June 30	Balance c/d		\$50
			<u>\$50</u>				<u>\$50</u>
July 1	Balance b/d		50	July 1	Commission Revenue	GJ33	50

A similar situation arises here as with accrued expenses. When the \$200 for commission is received in cash, it is entered into the journal and posted to the Commission Revenue account.

Therefore, to record that the \$50 is not revenue of the new period and that the business does not still have an asset, it is necessary to make the reversing entry:

General Journal					P33
Date	Particulars	Ref	Dr	Cr	
			\$	\$	\$
July 1	Commission Revenue Accrued Revenues (Reversing entry)	1103 3107	50		50

Prepaid expenses

In the case of prepaid expenses, no reversing entry is required as the effect of the balance day adjustment was to allocate the expense to the present accounting period and the asset accounts Prepaid Insurance and Supplies remain.

Unearned revenues

The ledger accounts after the reversing entry appear as:

Rent Revenue				No 1106			
			\$				\$
June 30	Unearned Revenues	GJ31	450	June 7	Cash	GJ11	630
	Profit or Loss Summary	GJ32	2 070	14	Cash	GJ18	630
				21	Cash	GJ20	630
				28	Cash	GJ26	630
			<u>\$2 520</u>				<u>\$2 520</u>
				July 1	Unearned Revenues	GJ33	450
Unearned Revenues				No 4105			
			\$				\$
June 30	Balance c/d		450	June 30	Rent Revenue	GJ31	450
			<u>\$450</u>				<u>\$450</u>
July 1	Rent Revenue	GJ33	450	July 1	Balance b/d		450

In the new accounting period, the rent will be earned and so it should be shown in the Rent Revenue account. Further, once the revenue is earned, the business will no longer have a liability.

General Journal					P33
Date	Particulars	Ref	Dr	Cr	
			\$	\$	\$
July 1	Unearned Revenues Rent Revenue (Reversing entry)	4105 1105	450		450

Except for the prepaid expenses, for each of the balance day adjustments at the beginning of this chapter, reversing entries are needed so that the situation is 'correct' in the period after the balance day adjustments are made. These balance day adjustments, and hence the reversing entries, are necessary because the accounting period interrupts the natural flow of these transactions.

The complete accounting process or cycle now appears as shown in Figure 6.7.

- 1 Prepare or collect source documents to verify that transactions have occurred.
- 2 Analyse transactions into their debit and credit elements, and enter into a journal.
- 3 Post the debit and credit elements to appropriate ledger accounts, and prepare a trial balance.
- 4 Record and post balance day adjustments.
- 5 Prepare end of period (month/year) financial reports.
- 6 Record and post closing entries at the end of the year.
- 7 Record and post reversing entries to allow the next yearly cycle of recording to commence.

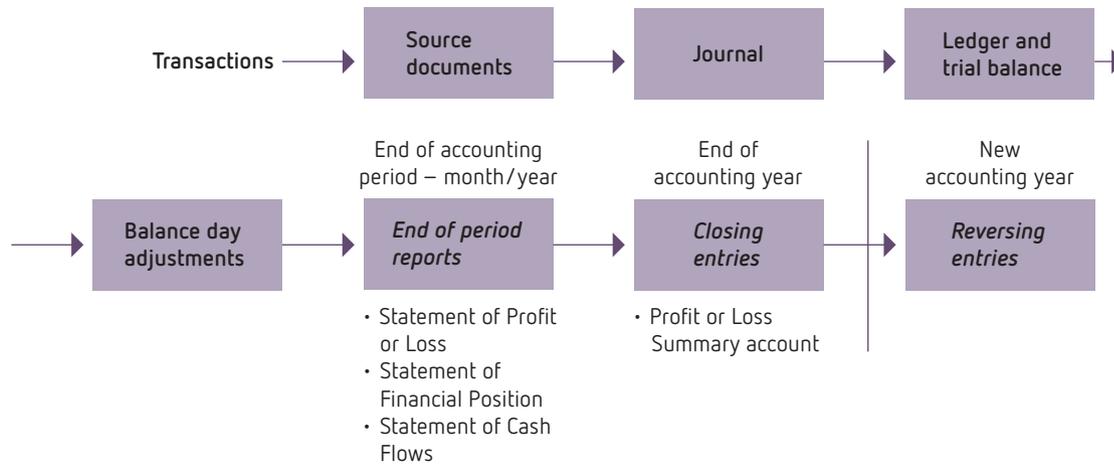


Figure 6.7 The complete accounting process

Check for understanding

6.22 **Explain** the concept of reversing entries, including when and why they are made.

Preparation of end of year financial statements for a trading organisation

Now that you have completed the full accounting process for a service organisation, we can turn our attention to the process for a trading organisation. You will see that they are quite similar. However, there are two main differences:

- It was assumed that the service business was not registered for GST and so there were no GST accounts. The trading organisation in the following example is registered for GST and will therefore need to account for the GST for the financial period. These entries will be shown below.
- A trading organisation will be keen to know the gross profit it has earned, as well as the net profit.

Gross profit or gross loss is the difference between the revenues earned from the sale of inventories and the cost of goods sold.

Net profit or net loss is the final profit or loss made by a business after taking into account all revenues and expenses for an accounting period.

For an organisation that is primarily a trading organisation, the importance of earning a gross profit sufficient to cater for all of the other expenses of the business cannot be overemphasised. A trading organisation needs to monitor this gross profit, as we will when we turn our attention to the analysis and interpretation of the accounting reports of our example trading organisation.

GST clearing entries

In order to determine the net amount of GST that is payable or refundable for a period, and to show this as one figure in the Statement of Financial Position, the GST Collected account and the GST Credits Received account are cleared to the GST Clearing account. Although these entries are not balance day adjustments, as they do not affect profit, they are necessary to complete the accounting process and to show the net amount of GST in the Statement of Financial Position.

These clearing entries, generally prepared at the end of each month, perform two functions:

- They clear the individual GST accounts ready for the next period.
- They transfer the balances of the GST accounts to the Clearing account so that the GST Clearing account in the Statement of Financial Position will show the resulting GST at the end of this period, and the amount to be paid or refunded at the appropriate time during the next period.

Assume the GST Collected and GST Credits Received accounts appear as follows:

Dr		Ledger				Cr	
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount
			\$				\$
			GST Collected				No 4102.2
				During year			1 400
			GST Credits Received				No 4102.2A
	During year		500				

The clearing entries will be:

General Journal					P91
Date	Particulars	Ref	Dr	Cr	
			\$	\$	
June 30	GST Collected	4102.2	1 400		
	GST Clearing (Clearing the GST Collected account)	4102.1		1 400	
	GST Clearing	4102.1	500		
	GST Credits Received (Clearing the GST Credits Received account)	4102.2A		500	

The balance of the GST Clearing account will either be an amount to be paid to the ATO or a refund to come from the ATO. In this case, because the amount collected is greater than the tax credits, \$900 will be payable and forwarded to the ATO along with the Business Activity Statement (BAS) at the appropriate date. This is shown below:

Dr		Ledger				Cr	
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount
			\$				\$
			GST Clearing				No 4102.1
June 30	GST Credits Rec	GJ91	500	June 30	GST Collected	GJ91	1 400
			GST Collected				No 4102.2
June 30	GST Clearing	GJ91	1 400	During year			1 400
			GST Credits Received				No 4102.2A
During year			500	June 30	GST Clearing	GJ91	500

Check for understanding

- 6.23 **Explain** the difference between the gross profit and the net profit for a business.
- 6.24 **a Explain** the purpose of a GST Clearing account.
- b** The recording system for GST described in this book involves three accounts: GST Collected, GST Credits Received and GST Clearing. **Evaluate** whether it would be possible to have only one account (such as the GST Clearing account) and to post all transactions to this account.
- 6.25 **Analyse** the following information for J Tyler:
- a prepare** journal entries to clear the GST accounts
- b prepare** the individual GST accounts
- c calculate** the amount of GST owing or refundable.

J Tyler			
Trial Balance (extract) as at 31 December			
Account no	Account	Debit \$	Credit \$
4102.2	GST Collected		50 435
4102.2A	GST Credits Received	29 650	

Presentation of the financial statements for a trading organisation

Now that we have discussed the differences between a service organisation and a trading organisation, and we have examined the entire accounting process for a financial year, the process will be illustrated for a trading organisation using the example of Carrier Enterprises.

Carrier Enterprises is a business taken over by J Bartrim. On 1 December 2026 the business had the following assets and liabilities: Cash \$1000, Inventories \$20 000, Vehicle \$10 000, Land \$50 000, Buildings \$80 000, and Accounts Payable: Austin Ltd \$250. The new business began trading on 1 December and the end of the financial year is 31 December 2026. For simplicity, assume there are no accounts receivable or accounts payable ledgers.

2026	
Dec 1	Paid a one-year insurance policy \$2400 (plus GST), bank payment 16287.
2	Sold goods with a cost price of \$750 to B Murray for \$2000 (GST-free), tax invoice no. 87.
4	Cash sales of goods with a cost price of \$1550 for \$3000 (plus GST).
6	Cash purchases \$1000 (plus GST), bank payment 16300.
7	Paid sales salaries \$800, bank payment 16317.
10	Received commission \$1100 (GST-inclusive), bank deposit 260728143.
12	Bought GST-free goods on credit from Austin Ltd on invoice 28, \$400.
15	Paid Austin Ltd \$200, bank payment 18320.
19	Returned goods to Austin Ltd to the value of \$100, adjustment note 8.
21	Received rent \$2200 (GST-inclusive), bank deposit 268278300.
22	Paid office salaries \$200, bank payment 18970.
24	Owner withdrew goods to the value of \$275 (GST-inclusive) for own use, inter-office memo no 201.
29	B Murray returned GST-free goods \$200, adjustment note 55. Cost price is zero as goods cannot be resold.
30	Paid delivery van expenses \$440 (GST-inclusive) and advertising \$1760 (GST-inclusive), bank payment 20761.
<i>Additional information</i>	
<ul style="list-style-type: none"> • Insurance for month is \$200. • Sales salaries owing total \$500. • Rent owing to the business at 31 December 2026 is \$500. • Of the commission received, \$100 was received in advance. 	

General Journal				
Date	Particulars	Ref	Dr \$	P99 Cr \$
Dec 1	Prepaid Insurance	3109	2 400	
	GST Credits Received	4102.2A	240	
	Cash at Bank	3103		2 640
	(Paid one-year insurance policy \$2640, bank payment 16287)			
2	B Murray	3104.1	2 000	
	Sales	1101		2 000
	(Sold GST-free goods, tax invoice 87)			
	Cost of Goods Sold	2105	750	
	Inventories	3106		750
	(Cost of goods sold on tax invoice 87)			
4	Cash at Bank	3103	3 300	
	GST Collected	4102.2		300
	Sales	1101		3 000
	(Sold inventories)			
	Cost of Goods Sold	2105	1 550	
	Inventories	3106		1 550
	(Cost of goods sold)			

6	Inventories GST Credits Received Cash at Bank (Purchased inventories, bank payment 16300)	3106 4102.2A 3103	1 000 100	1 100
7	Sales Salaries Cash at Bank (Paid sales salaries, bank payment 16317)	2305 3103	800	800
10	Cash at Bank GST Collected Commission Revenue (Received commission, bank deposit 260728143)	3103 4102.2 1103	1 100	100 1 000
12	Inventories Austin Ltd (Purchased GST-free goods from Austin Ltd, tax invoice 28)	3106 4101.1	400	400
15	Austin Ltd Cash at Bank (Paid Austin Ltd \$200, bank payment 18320)	4101.1 3103	200	200
19	Austin Ltd Inventories (Returned goods to Austin Ltd, adjustment note 8)	4101.1 3106	100	100
21	Cash at Bank GST Collected Rent Revenue (Received rent, bank deposit 268278300)	3103 4102.2 1106	2 200	200 2 000
22	Office Salaries Cash at Bank (Paid office salaries, bank payment 18970)	2411 3103	200	200
24	Drawings GST Credits Received Inventories (Owner withdrew goods for own use, inter-office memo 201)	5101A 4102.2A 3106	275	25 250
29	Sales Returns and Allowances B Murray (GST-free goods returned, adjustment note 55)	1101A 3104.1	200	200
30	Delivery Vehicle Expenses Advertising GST Credits Received Cash at Bank (Paid delivery van expenses and advertising, bank payment 20761)	2303 2301 4102.2A 3103	400 1 600 200	2 200

The balance day adjustments are recorded as:

General Journal					
Date	Particulars	Ref	P100		
			Dr \$	Cr \$	
Dec 31	Insurance	2408	200	200	
	Prepaid Insurance (Prepaid insurance for month, \$200)	3109			
	Sales Salaries	2305	500		500
	Accrued Expenses (Salaries owing at 31 December)	4104			
Accrued Revenues	3108	500	500		
Rent Revenue (Rent revenue owing at 31 December)	1106				
Dec 31	Commission Revenue	1103	100	100	
	Unearned Revenues (Commission revenue received in advance)	4105			

The GST clearing entries would be recorded as:

Dec 31	GST Collected	4102.2	600	600
	GST Clearing (Clearing GST collected to the GST Clearing account)	4102.1		
Dec 31	GST Clearing	4102.1	515	515
	GST Credits Received (Clearing GST credits received to the GST Clearing account)	4102.2A		

The closing entries would be recorded as:

Dec 31	Sales	1101	5 000	8 400	
	Commission Revenue	1103			
	Rent Revenue	1106			
	Profit or Loss Summary (Closing off revenue accounts to Profit or Loss Summary)	5102			
Dec 31	Profit or Loss Summary	5102	6 200	200	
	Sales Returns and Allowances	1101A			
	Cost of Goods Sold	2105			2 300
	Advertising	2301			1 600
	Delivery Vehicle Expenses	2303			400
	Sales Salaries	2305			1 300
	Insurance	2408			200
	Office Salaries	2411			200
	(Closing off expenses to Profit or Loss Summary)				
	Profit or Loss Summary	5102			2 200
Capital (Transfer of net profit to the Capital account)	5101				
Dec 31	Capital	5101	275	275	
	Drawings (Closing off drawings to the Capital account)	5101A			

Carrier Enterprises Ledger							
Dr				Cr			
Date	Particulars	Ref	Amount	Date	Particulars	Ref	Amount
			\$				\$
Sales				No 1101			
Dec 31	Profit or Loss Summary	G100	5 000	Dec 2	B Murray	G99	2 000
					4 Cash	G99	3 000
			<u>\$5 000</u>				<u>\$5 000</u>
Sales Returns and Allowances				No 1101A			
Dec 29	B Murray	G99	<u>200</u>	Dec 31	Profit or Loss Summary	G100	<u>200</u>
			<u>\$200</u>				<u>\$200</u>
Commission Revenue				No 1103			
Dec 31	Unearned Revenues	G100	100	Dec 10	Cash	G99	1 000
	Profit or Loss Summary	G100	<u>900</u>				
			<u>\$1 000</u>				<u>\$1 000</u>
Rent Revenue				No 1106			
Dec 31	Profit or Loss Summary	G100	2 500	Dec 21	Cash	G99	2 000
					31 Accrued Revenue	G100	500
			<u>\$2 500</u>				<u>\$2 500</u>
Cost of Goods Sold				No 2105			
Dec 2	Inventories	G99	750	Dec 31	Profit or Loss Summary	G100	2 300
4	Inventories	G99	<u>1 550</u>				
			<u>\$2 300</u>				<u>\$2 300</u>
Advertising				No 2301			
Dec 30	Cash	G99	<u>1 600</u>	Dec 31	Profit or Loss Summary	G100	1 600
			<u>\$1 600</u>				<u>\$1 600</u>
Delivery Vehicle Expenses				No 2303			
Dec 31	Cash	CP30	<u>400</u>	Dec 31	Profit or Loss Summary	G100	<u>400</u>
			<u>\$400</u>				<u>\$400</u>
Sales Salaries				No 2305			
Dec 7	Cash	G99	800	Dec 31	Profit or Loss Summary	G100	1 300
	31 Accrued Expenses	G100	<u>500</u>				
			<u>\$1 300</u>				<u>\$1 300</u>
Insurance				No 2408			
Dec 31	Prepaid Insurance	G100	<u>200</u>	Dec 31	Profit or Loss Summary	G100	<u>200</u>
			<u>\$200</u>				<u>\$200</u>

Note: For the Ref column it is acceptable to use G100 instead of GJ100.

Office Salaries				No 2411			
Dec 22	Cash	G99	200	Dec 31	Profit or Loss Summary	G100	200
			<u>200</u>				<u>200</u>
			<u>\$200</u>				<u>\$200</u>
Cash at Bank				No 3103			
Dec 1	Balance b/d		1 000	Dec 1	Insurance and GST Credits	G99	2 640
4	Sales and GST Collected	G99	3 300	6	Inventories and GST Credits	G99	1 100
10	Commission and GST Collected	G99	1 100	7	Sales Salaries	G99	800
21	Rent and GST Collected	G99	2 200	15	Austin Ltd	G99	200
				22	Office Salaries	G99	200
				30	Delivery Vehicle Expense & Advertising	G99	2 200
			<u>7 600</u>	31	Balance c/d		460
			<u>\$7 600</u>				<u>\$7 600</u>
Jan 1	Balance b/d		460				
B Murray				No 3104.1			
Dec 2	Sales	G99	2 000	Dec 29	Sales Returns	G99	200
			<u>2 000</u>		Balance c/d		1 800
			<u>\$2 000</u>				<u>\$2 000</u>
Jan 1	Balance b/d		1 800				
Inventories				No 3106			
Dec 1	Balance b/d		20 000	Dec 2	Cost of Goods Sold	G99	750
6	Cash	G99	1 000		Cost of Goods Sold	G99	1 550
12	Austin Ltd	G99	400		Austin Ltd	G99	100
					Drawings	G99	250
			<u>21 400</u>		Balance c/d		18 750
			<u>\$21 400</u>				<u>\$21 400</u>
Jan 1	Balance b/d		18 750				
Accrued Revenues				No 3108			
Dec 31	Rent Revenue	G100	500	Dec 31	Balance c/d		500
			<u>500</u>				<u>500</u>
			<u>\$500</u>				<u>\$500</u>
Jan 1	Balance b/d		500				
Prepaid Insurance				No 3109			
Dec 1	Cash	G99	2 400	Dec 31	Insurance	G100	200
			<u>2 400</u>		Balance c/d		2 200
			<u>\$2 400</u>				<u>2 200</u>
Jan 1	Balance b/d		2 200				<u>\$2 400</u>

Vehicles				No 3303			
Dec 1	Balance b/d		10 000	Dec 31	Balance c/d		10 000
			<u>\$10 000</u>				<u>\$10 000</u>
Jan 1	Balance b/d		10 000				
Building				No 3305			
Dec 1	Balance b/d		80 000	Dec 31	Balance c/d		80 000
			<u>\$80 000</u>				<u>\$80 000</u>
Jan 1	Balance b/d		80 000				
Land				No 3306			
Dec 1	Balance b/d		50 000	Dec 31	Balance c/d		50 000
			<u>\$50 000</u>				<u>\$50 000</u>
Jan 1	Balance b/d		50 000				
Austin Ltd				No 4101.1			
Dec 15	Cash	G99	200	Dec 1	Balance b/d		250
19	Inventories	G99	100		Inventories	G99	400
31	Balance c/d		350				
			<u>\$650</u>				<u>\$650</u>
				Jan 1	Balance b/d		350
GST Clearing (Payable)				No 4102.1			
Dec 31	GST Credits Received	G100	515	Dec 31	GST Collected	G100	600
	Balance c/d		85				
			<u>\$600</u>				<u>\$600</u>
				Jan 1	Balance b/d		85
GST Collected				No 4102.2			
Dec 31	GST Clearing	G100	600	Dec 4	Cash	G99	300
					Cash	G99	100
					Cash	G99	200
			<u>\$600</u>				<u>\$600</u>
GST Credits Received				No 4102.2A			
Dec 1	Cash	G99	240	Dec 24	Drawings	G99	25
6	Cash	G99	100		GST Clearing	G100	515
30	Cash	G99	200				
			<u>\$540</u>				<u>\$540</u>

Accrued Expenses				No 4104			
Dec 31	Balance c/d		<u>500</u>	Dec 31	Sales Salaries	G100	<u>500</u>
			<u>\$500</u>				<u>\$500</u>
				Jan 1	Balance b/d		500
Unearned Revenues				No 4105			
Dec 31	Balance c/d		<u>100</u>	Dec 31	Commission Revenue	G100	<u>100</u>
			<u>\$100</u>				<u>\$100</u>
				Jan 1	Balance b/d		100
Capital				No 5101			
Dec 31	Drawings	G100	275	Dec 1	Balance b/d		160 750
	Balance c/d		<u>162 675</u>		Profit or Loss Summary	G100	<u>2 200</u>
			<u>\$162 950</u>				<u>\$162 950</u>
				Jan 1	Balance b/d		162 675
Drawings				No 5101A			
Dec 24	Inventories & GST	G99	<u>275</u>	Dec 31	Capital	G100	<u>275</u>
			<u>\$275</u>				<u>\$275</u>
Profit or Loss Summary				No 5102			
Dec 31	Sales Returns	G100	200	Dec 31	Sales	G100	5 000
	Cost of Goods Sold	G100	2 300		Commission Revenue	G100	900
	Advertising	G100	1 600		Rent Revenue	G100	2 500
	Delivery Vehicle						
	Expenses	G100	400				
	Sales Salaries	G100	1 300				
	Insurance	G100	200				
	Office Salaries	G100	200				
	Capital (net profit)	G100	<u>2 200</u>				
			<u>\$8 400</u>				<u>\$8 400</u>

The trial balance on the next page is prepared before adjustments to check the accuracy of posting the initial transactions. The balance day adjustments are then recorded. This results in more accurate figures appearing in the Statement of Profit or Loss (page 277) and the Statement of Financial Position (page 278).

Carrier Enterprises
Trial Balance (before adjustments) as at 31 December 2026

No	Account	Debit \$	Credit \$
1101	Sales		5 000
1101A	Sales Returns and Allowances	200	
1103	Commission Revenue		1 000
1106	Rent Revenue		2 000
2105	Cost of Goods Sold	2 300	
2301	Advertising	1 600	
2303	Delivery Vehicle Expenses	400	
2305	Sales Salaries	800	
2411	Office Salaries	200	
3103	Cash at Bank	460	
3104.1	B Murray	1 800	
3106	Inventories	18 750	
3109	Prepaid Insurance	2 400	
3303	Vehicles	10 000	
3305	Building	80 000	
3306	Land	50 000	
4101.1	Austin Ltd		350
4102.2	GST Collected		600
4102.2A	GST Credits Received	515	
5101	Capital		160 750
5101A	Drawings	275	
		<u>\$169 700</u>	<u>\$169 700</u>

Carrier Enterprises
Statement of Profit or Loss for month ended 31 December 2026

	\$	\$
Sales	5 000	
<i>Less Sales Returns</i>	<u>200</u>	4 800
Less Cost of Goods Sold		<u>2 300</u>
Gross profit		2 500
Add Other Revenue		
Commission Revenue	900	
Rent Revenue	<u>2 500</u>	<u>3 400</u>
		5 900
Less Other Expenses		
Advertising	1 600	
Delivery Vehicle Expenses	400	
Sales Salaries	1 300	
Insurance	200	
Office Salaries	<u>200</u>	<u>3 700</u>
Net profit		<u>\$2 200</u>

Carrier Enterprises			
Statement of Financial Position as at 31 December 2026			
		\$	\$
Assets			
Cash at Bank		460	
Accounts Receivable		1 800	
Inventories		18 750	
Accrued Revenues		500	
Prepaid Insurance		2 200	
Vehicles		10 000	
Building		80 000	
Land		<u>50 000</u>	163 710
Less Liabilities			
Accounts Payable		350	
GST Clearing (Payable)		85	
Accrued Expenses		500	
Unearned Revenues		<u>100</u>	<u>1 035</u>
Net assets			<u><u>\$162 675</u></u>
Owner's Equity			
Capital (1 December 2026)		160 750	
Add Net profit		<u>2 200</u>	
		162 950	
Less Drawings		<u>275</u>	<u><u>\$162 675</u></u>

The reversing entries to begin the new financial year would be recorded as:

General Journal				
Date	Particulars	Ref	Debit \$	P101 Credit \$
Jan 1	Accrued Expenses	4104	500	
	Sales Salaries	2305		500
	(Reversing entry)			
	Rent Revenue	1106	500	
	Accrued Revenues	3108		500
	(Reversing entry)			
	Unearned Revenues	4105	100	
	Commission Revenue	1103		500
	(Reversing entry)			

Return on owner's equity

Now that the records and reports have been prepared for a full accounting period, the figures can be used to provide some insight into the operations for various stakeholders and to support any decisions about the future directions of the business. One key calculation would be to calculate the return on owner's equity made in the period.

Return on owner's equity is calculated by:

$$\frac{\text{Net profit}}{\text{Average owner's equity}} \times 100$$

Average owner's equity is calculated by taking the owner's equity at the beginning of the period, adding to this the owner's equity at the end of the period and then dividing this by 2. This is considered to be a more accurate figure than just taking the opening or closing owner's equity figure.

For example, if we look at the results for Carrier Enterprises, the return on owner's equity would be:

$$\frac{2200}{(160\,750 + 162\,675)/2} \times 100$$

$$\frac{2200}{161\,712.50} \times 100$$

The return is 1.36 per cent for one month of trading. From the point of view of the owner, it may be preferable to liquidate the business and invest their capital into the bank. They would make a larger return and there is no risk involved. However, they have just begun a business and so they probably think there will be greater returns in the future.

This is just one of the factors that would assist the owner in charting a way forward.

Check for understanding

6.26 Analyse the following information for Gazzaro Tiles and **prepare**:

- a the Profit or Loss Summary account
- b the Capital and Drawings accounts.

Gazzaro Tiles		
Trial Balance (extract) as at 30 June		
Account	Debit \$	Credit \$
Sales		100 000
Sales Returns	2 000	
Interest Revenue		1 000
Cost of Goods Sold	80 000	
Delivery Expenses	10 000	
Sales Salaries	20 000	
Insurance	5 000	
Interest Expense	1 000	
Rent	2 000	
Commission Revenue		1 500
Capital		150 000
Drawings	25 000	

- 6.27 Analyse** the following information for Stams Exploring and **calculate** the profit (or loss) made for the year ending 30 June. Support your profit (or loss) figures by **preparing** the Statement of Profit or Loss.

Stams Exploring		
Trial Balance (extract) as at 30 June		
Account	Debit	Credit
	\$	\$
Sales		83 700
Returns Inwards	2 850	
Commission Revenue		10 000
Cost of Goods Sold	49 890	
Delivery Van Expenses	8 500	
Cartage Outwards	3 200	
Stationery	1 000	
Insurance	2 000	
Telephone Expense	897	
Rent Revenue		721
<i>Additional information</i>		
Commission of \$1000 is owing at 30 June.		

- 6.28 Prepare** a Statement of Profit or Loss from the following yearly figures for Le Blanc Sealing:

Le Blanc Sealing		
Trial Balance (extract) as at 30 June		
Account	Debit	Credit
	\$	\$
Sales		20 000
Interest Revenue		100
Sales Returns	2 000	
Advertising	500	
Cost of Goods Sold	7 000	
Sales Commission	1 500	
Sales Salaries	1 750	
Interest Expense	100	
Electricity	1 000	
Office Wages	2 000	
Rates	2 000	
Commission Revenue		1 600
Rent Revenue		200
<i>Additional information</i>		
Advertising costs were incurred to promote a product that will not be on sale until 1 January of the next year.		

6.29 Analyse the following ledger accounts and the additional information for Olsen Trading and **prepare:**

- a balance day adjustments
- b the Statement of Profit or Loss for the year ended 30 June.

Commission Revenue	\$200	Electricity	\$400
Interest Revenue	\$1 000	Interest Expense	\$200
Delivery Expenses	\$500	Sales	\$25 000
Cost of Goods Sold	\$6 950	Sales Returns	\$1 000
Office Wages	\$2 000	Prepaid Insurance	\$1 000
Sales Commission	\$1 000	Advertising	\$2 000
Rent Revenue	\$400	Stationery	\$2 000
Drawings	\$500	Capital	\$40 000
<i>Additional information</i>		<i>Additional information</i>	
<ul style="list-style-type: none"> • Office wages owing at 30 June total \$500. • Commission received in advance is \$100. 		<ul style="list-style-type: none"> • Insurance expense is \$800. • Rent owing at 30 June is \$100. 	

- 6.30 Analyse** the following information for Reis Wholesale and then **prepare**:
- journal entries for the balance day adjustments and for clearing the GST accounts
 - the main ledger accounts that are affected (Advertising, Office Wages, and GST accounts)
 - a Statement of Profit or Loss for the year ended 30 June and a Statement of Financial Position as at that date (in account form).

Reis Wholesale		
Trial Balance as at 30 June		
Account	Debit	Credit
	\$	\$
Sales		50 000
Sales Returns	1 000	
Commission Revenue		2 000
Cost of Goods Sold	18 750	
Advertising	1 000	
Travel Expenses	750	
Interest Revenue		250
Selling Expenses	1 100	
Office Wages	875	
Stationery	200	
Insurance	400	
Electricity	400	
Telephone Expenses	200	
Cash at Bank	8 000	
Accounts Receivable	9 000	
Inventories	11 000	
Land	20 000	
Buildings	30 000	
Vehicles	22 000	
Accounts Payable		7 000
GST Collected		4 000
GST Credits Received	2 000	
Mortgage		10 000
Capital		54 425
Drawings	1 000	
	<u>\$127 675</u>	<u>\$127 675</u>
<i>Additional information</i>		
• Advertising of \$200 was prepaid.		
• Office wages of \$800 are owing.		

6.31 Analyse the following information for Habib Enterprises and **prepare** a Statement of Profit or Loss for the year ended 30 June and a Statement of Financial Position as at that date (in narrative form):

Habib Enterprises		
Trial Balance as at 30 June		
Account	Debit	Credit
	\$	\$
Interest Expense	150	
Office Wages	13 000	
Sales		150 000
V Campbell	1 350	
D Hall		875
Rent Revenue		1 275
Office Furniture	10 000	
Inventories	10 500	
Advertising	3 000	
Cash at Bank	10 000	
Sales Returns	1 500	
Equipment	20 000	
Selling Expenses	13 000	
Vehicles	25 000	
Buildings	15 000	
Land	15 000	
Cost of Goods Sold	75 750	
Mortgage		10 000
Goodwill	50 000	
Prepaid Insurance	1 000	
Shares in TX Co	10 000	
Office Expenses	2 770	
S Mayne	880	
M Wallace		1 000
GST Collected		13 000
GST Credits Received	8 000	
Capital		118 750
Drawings	9 000	
	<u>\$294 900</u>	<u>\$294 900</u>
<i>Additional information</i>		
• Advertising owing totals \$500.		
• Insurance expense is \$750.		
• Rent received in advance is \$275.		
• Interest owing is \$500.		

6.32 Follow the weblink to the 2023 annual report for Woolworths Limited, **analyse** the report and answer the following questions.

- a What years are compared in the report?
- b What is the value for each of the following items in the Statement of Profit or Loss?
 - i sales revenue
 - ii cost of goods sold (cost of sales)
 - iii gross profit
 - iv net (operating) profit
- c What format is used to present the Statement of Financial Position?



Weblink
Woolworths
Limited annual
report

Accounting technology – spreadsheets and accounting packages

The two most important technologies that can be used for end of month and end of year processing are the spreadsheet and the accounting package.

Spreadsheets are often used to make the preparation of the financial statements easier. Every month, the most common accounts are used and it is only the amounts that change. At this stage, you will be required to build a spreadsheet with no Input area. In *Units 3 & 4*, the use of Input and Report areas will be emphasised. However, it is very important that formulas are used in the correct place, that correct formatting is used, and that proofs are built into the spreadsheet to highlight any errors.

Various business graphics in Excel can also be used to display visually the main figures and relationships that result from the reports. Single month/year figures will be used at this point in time, but the graphs will be more beneficial when comparative data are used later.

The accounting package enables the output of reports at any time. Once balance day adjustments are recorded, the various reports can be printed. In MYOB AccountRight, because the balance day adjustments are general journal entries, they are recorded through the menu options Accounts, Record Journal Entry as per Figures 5.7 and 5.8 on pages 166–7.

Because the financial reports in MYOB AccountRight are internal reports, they do not necessarily have to conform to the names stipulated by the accounting standards. As a result, a Profit & Loss Statement (sometimes called an Income Statement) will be output instead of a Statement of Profit or Loss, and a Balance Sheet will be output instead of a Statement of Financial Position. You should become familiar with these similar terms. To output the financial statements, use the menu options Reports, Accounts, Profit & Loss Statement; and Reports, Accounts, Balance Sheet.

To re-create the effect of posting a series of transactions during the month or year in the following two exercises, you will be asked to enter a trial balance as a single general journal entry. Of course, in practice, this trial balance would have come from all the transactions that actually occurred. For now, simulate this financial position by entering the data as a single general journal entry through menu options Accounts, Record Journal Entry.

Finally, Question 6.35 is provided to reinforce how the various menu options are used in an accounting package to record transactions, and the use of the subsidiary ledger technique.

Check for understanding

6.33 **Analyse** the following information:

Newtown Trading		
Trial Balance as at 30 April 2026		
Account	Debit \$	Credit \$
Sales		15 000
Sales Returns and Allowances	600	
Commission Revenue		3 000
Interest Revenue		15
Rent Revenue		6 000
Cost of Goods Sold	6 900	
Advertising	3 000	
Motor Vehicle Expenses	3 600	
Wages and Salaries	2 400	
Cash at Bank	1 380	
Accounts Receivable	5 400	
Prepaid Insurance	7 200	
Inventories	56 250	
Vehicles	30 000	
Building	45 000	
Land	45 000	
Accounts Payable		1 035
GST Collected		1 800
GST Credits Received	1 545	
Capital		182 250
Drawings	825	
	<u>\$209 100</u>	<u>\$209 100</u>

Additional information

- Insurance of \$6600 was considered to be paid in advance at 30 April.
- Wages owing are \$1500.
- Rent owing to the business at 30 April is \$1500.
- Commission of \$300 was received in advance.

a Prepare:

- i** journal entries for the balance day adjustments and the GST Clearing
- ii** a Statement of Profit or Loss for the month (also end of year), created in a spreadsheet with Other expenses in alphabetical order. Use appropriate formulas, formatting and proofs. Print the statement for presentation to the owner and a printout showing formulas
- iii** a Statement of Financial Position, created in a spreadsheet. Use appropriate formulas, formatting and proofs. Print the statement for presentation to the owner and a printout showing formulas
- iv** reversing entries for applicable balance day adjustments
- v** bar charts showing net sales, gross profit and net profit in both \$ terms and % of net sales using the information on pages 213–6
- vi** a pie chart showing individual assets and liabilities, using the information on page 215.

- b** Using MYOB AccountRight or a similar accounting package, **prepare** the following:
- i** Create a new MYOB file for this business. Click on the Create button and complete the information for the MYOB product name, company name and financial year ending April 2026. Use an account list provided by MYOB for a wholesale business; and enter the name of the file and where the file will be saved. Then click on Command Centre. Refer back to page 193 for guidance.
 - ii** Create new accounts through Accounts, Accounts List, New for the following:
 - Other Asset, 1-1344 Accrued Revenues
 - Other Asset, 1-1346 Prepaid Insurance
 - Other Liability, 2-1595 Accrued Expenses
 - Other Liability, 2-1598 Unearned Revenues
 - Other Income, 8-0050 Commission Revenue
 - Other Income, 8-1200 Rent Revenue.
 - iii** Edit existing account names through Accounts, Accounts List. Click on account to be edited. Edit for the following:
 - 1-1110 Edit to Bank Account
 - 1-2510 Edit to Motor Vehicles At Cost
 - 3-1000 Edit to Owner's Capital
 - 3-2000 Edit to Owner's Drawings
 - 4-1000 Edit to Sales
 - 4-2000 Edit to Sales Returns
 - 6-8400 Edit to Motor Vehicle Expenses
 - 8-1000 Edit to Interest Revenue.

The names do not have to be exactly the same as in the trial balance above. For example, 1-1310 can be left as Trade Debtors, instead of Accounts Receivable; 2-1510 Trade Creditors, instead of Accounts Payable; and 5-1000 Cost of Sales, instead of Cost of Goods Sold. So long as the account name conveys the correct meaning, alternative account names can be left the same at this point.
 - iv** Print an Account List so that you know the account numbers for each account.
 - v** Input the above trial balance as a single general journal entry at 30 April through Accounts, Record journal entry. This will simulate the transactions that occurred up until 30 April. Use the Tab key to move to each field, and ensure that all entries have N-T as the GST code. Print a trial balance at 30 April before making any adjustments to see if it matches the trial balance above. The accounts will be in a different order, but that does not matter.
 - vi** At 30 April, record the balance day adjustments through Accounts, Record journal entry with all GST codes N-T. (Do not record any entries relating to clearing the GST accounts.)
 - vii** Print a Profit & Loss Statement.
 - viii** Print a Balance Sheet.
 - ix** Note any similarities and differences between the output from a(ii) and b(vii), and that from a(iii) and b(viii).

6.34 Analyse the following information:

Cooper Enterprises		
Trial Balance as at 30 June 2026		
Account	Debit	Credit
	\$	\$
Dividend Revenue		1 000
Cash at Bank	10 000	
Mortgage		50 000
Inventories	29 000	
Travel Expenses	1 000	
Shares in AGC Ltd	10 000	
Sales Returns	3 000	
Accounting Fees	500	
Office Furniture	15 000	
Accounts Receivable	12 500	
Loan from Bank		15 000
Drawings	30 000	
Capital – A Cooper		84 750
Cash on Hand	1 000	
Prepaid Insurance	6 000	
Sales		98 000
Commission Revenue		3 000
Office Expenses	4 000	
Motor Vehicle Expenses	3 500	
Telephone Expense	5 000	
Cost of Goods Sold	25 000	
Rent Revenue		5 000
Land	50 000	
Advertising	10 000	
Accounts Payable		3 750
GST Collected		9 000
GST Credits Received	4 000	
Motor Vehicle	20 000	
Building	30 000	
	<u>\$269 500</u>	<u>\$269 500</u>
<i>Additional information</i>		
• Insurance of \$5000 had been consumed.		
• Rent of \$250 was received in advance.		
• Advertising owing is \$2000.		
• Commission revenue owing is \$575.		
• Interest owing on loans is \$2000.		

- a Prepare:**
- i** journal entries for the balance day adjustments and the GST Clearing
 - ii** a Statement of Profit or Loss for the year, created in a spreadsheet with Other expenses in alphabetical order. Use appropriate formulas, formatting and proofs. Print the statement for presentation to the owner and a printout showing formulas
 - iii** a Statement of Financial Position, created in a spreadsheet. Use appropriate formulas, formatting and proofs. Print the statement for presentation to the owner and a printout showing formulas
 - iv** reversing entries for applicable balance day adjustments
 - v** pie charts showing the individual items that make up total revenues and total expenses, using the information on page 215
 - vi** a bar chart showing total assets, liabilities and owner's equity, using the information on pages 213–4.
- b** Using MYOB AccountRight or similar accounting package **prepare** the following:
- i** Create a new MYOB file for this business. Click on the Create button and complete the information for the MYOB product name, company name and financial year end June 2026. Use an account list provided by MYOB for a wholesale business, and enter the name of the file and where the file will be saved. Next click on Command Centre. Refer back to page 193 for guidance.
 - ii** Create new accounts through Accounts, Accounts List, New for the following:
 - Other Asset, 1-1050 Cash On Hand
 - Other Asset, 1-1344 Accrued Revenues
 - Other Asset, 1-1346 Prepaid Insurance
 - Fixed Asset, 1-2050 Shares in AGC Ltd
 - Other Liability, 2-1595 Accrued Expenses
 - Other Liability, 2-1598 Unearned Revenues
 - Expense, 6-0050 Interest on Loans
 - Other Income, 8-0050 Commission Revenue
 - Other Income, 8-0070 Dividend Revenue
 - Other Income, 8-1200 Rent Revenue.
 - iii** Edit existing account names through Accounts, Accounts List. Click on account to be edited. Edit for the following:
 - 1-1110 Edit to Bank Account
 - 1-2510 Edit to Motor Vehicles At Cost
 - 2-2100 Edit to Loan From Bank
 - 2-2200 Edit to Mortgage
 - 3-1000 Edit to Owner's Capital
 - 3-2000 Edit to Owner's Drawings
 - 4-1000 Edit to Sales
 - 4-2000 Edit to Sales Returns
 - 6-1900 Edit to Office Expenses
 - 6-8400 Edit to Motor Vehicle Expenses.

The names do not have to be exactly the same as in the trial balance above. For example, 1-1310 can be left as Trade Debtors, instead of Accounts Receivable; 2-1510 Trade Creditors, instead of Accounts Payable; and 5-1000 Cost of Sales, instead of Cost of Goods Sold. So long as the account name conveys the correct meaning, alternative account names can be left the same at this point.
 - iv** Print an Account List so that you know the account numbers for each account.
 - v** Input the above trial balance as a single general journal entry at 30 June through Accounts, Record journal entry. This will simulate the transactions that occurred up until 30 June. Use the Tab key to move to each field and ensure that all entries have N-T as the GST code. Print a trial balance at 30 June before making any adjustments to see that it matches the trial balance above. The accounts will be in a different order but that does not matter.

- vi At 30 June, record the balance day adjustments through Accounts, Record journal entry with all GST codes N-T. (Do not record any entries relating to clearing the GST accounts.)
 - vii Print a Profit & Loss Statement.
 - viii Print a Balance Sheet.
 - ix Reflect once again on any similarities and differences between the output from a(ii) and b(vii) and that from a(iii) and b(viii).
- c Why do you think the Drawings account is so high?

Interesting accounting fact

Did you know?

Accounting does not involve high-level mathematics

Accountants use basic arithmetic and simple equations. Computers do most of the maths. Accountants analyse and interpret the results.

Source: Visually: <https://visual.ly/community/Infographics/business/10-amazing-fun-facts-and-trends-about-accounting-profession>

- 6.35 To see how the various menu options are used in an accounting package to record transactions and to practise the subsidiary ledger technique, if you have not already done so, **prepare** solutions to the following questions:
- a Question 5.29 on page 203
 - b Question 5.30 on page 203
 - c Question 5.46 on page 221
-

CHAPTER REVISION

6.36 Multiple choice

Complete the following multiple-choice questions by choosing the best answer.

- 1 For a service business, revenue is recognised when:
 - A cash is received for the work performed
 - B goods are collected
 - C the service is performed
 - D quote is given for work.
- 2 The Statement of Profit or Loss:
 - A forms part of the double-entry procedure
 - B is prepared in the ledger
 - C can be prepared only at the end of the accounting year
 - D is a report.
- 3 Which of the following statements is incorrect?
 - A Cash flows are inflows and outflows of cash equivalents.
 - B A Statement of Cash Flows shows flows from operating, investing and financing activities during a period.
 - C Payment of owner's drawings is an operating outflow.
 - D The receipt of a loan repayment is an investing cash inflow.
- 4 You are given the following information for Smith Traders.

Smith Traders					
Ledger					
Date	Particulars	Ref	Dr \$	Cr \$	Balance \$
Cash at Bank					No 3103
July 1	Capital	G1	20 000		20 000 Dr
2	Service Fees	G1	1 000		21 000 Dr
2	Advertising	G1		1500	19 500 Dr
10	Motor Vehicle	G1		15 000	4 500 Dr
10	Prepaid Insurance	G1		1 500	3 000 Dr
30	Drawings	G1	500		2 500 Dr

Which of the following statements is correct?

- A The insurance expense for the month will be \$1500.
 - B Service fees and advertising are operating flows.
 - C The motor vehicle purchase is an operating flow.
 - D Drawings is an operating flow.
- 5 Accrued revenues are:
 - A revenues earned but not received
 - B revenues owing by the firm
 - C revenues received but not earned
 - D revenues listed in the Statement of Profit or Loss.

- 6 Prepaid expenses are:
- A an asset
 - B a liability
 - C a revenue
 - D an expense.
- 7 The following information relates to rent revenue:
 Rent received in advance at 30 June 2026 is \$1000.
 Rent received in cash during the year is \$15 000.
 Accrued rent at 30 June 2026 is \$2000.
 The rent revenue for the year ended 30 June 2026 is:
- A \$15 000
 - B \$16 000
 - C \$17 000
 - D \$18 000.
- 8 The following information relates to wages and salaries expense:
 Accrued wages at 30 June 2025 are \$5000.
 Accrued wages at 30 June 2026 are \$7000.
 Wages paid during the 2025/2026 year are \$16 000.
 The wages and salaries expense for the year ended 30 June 2026 is:
- A \$18 000
 - B \$16 000
 - C \$23 000
 - D \$14 000.

6.37 Case study

Synthesise the information in Stimuli 1 to 5 and **prepare** a Statement of Profit or Loss for the year ended 30 June 2026 for Nature Lovers.

STIMULUS 1

Some of the Reversing entries made on 1 July 2026

<i>July 1</i>	<i>Unearned rent revenue</i>	<i>450</i>
	<i>Rent revenue</i>	<i>450</i>

STIMULUS 2

Employees are paid every fortnight and the fortnightly wages bill is \$15 000. The end of the financial year is a Friday and the last payday was on 23 June.

STIMULUS 3

(Extract) Trial Balance before any adjustments

Rent revenue		6950
Wages and salaries	40 000	
Sales revenue		800 000
General expenses	300 000	

STIMULUS 4

A large advertising contract was signed and paid for on 15 June for \$32 000 to launch a new product. The campaign will commence in September 2026.

STIMULUS 5

MEMO FROM ACCOUNTANT TO CEO

30/6/2026: Our revenue policy is to have Cost of Goods Sold being 25 per cent of the sales value and this was achieved this year.

7

INTERNAL CONTROLS

LEARNING OBJECTIVES

At the end of this chapter you should be able to:

- describe internal controls
- describe the administrative and accounting controls for controlling credit – accounts receivable and accounts payable
- describe administrative controls and accounting controls used by a business for controlling inventories, including stocktakes
- explain the impact of not implementing internal controls for credit accounts and inventories
- explain the relationship between control of credit accounts and inventories and the effect on profitability and liquidity
- analyse and interpret accounting processes relating to the recording and controlling of accounts receivable, accounts payable and inventories.

*Internal controls***Nature and importance of internal controls**

- Internal accounting controls and administrative controls

Control over credit

- Importance of credit
- Credit transactions
- Why give credit?
- Internal control over accounts receivable
- Internal control over accounts payable
- Corporate credit cards

Control over inventories

- Importance of inventories
- Stocktaking (physical stocktake or physical inventory)
- Internal control over the purchase of inventories
- Internal control over the sale of inventories
- Internal control over stored inventories

Credit, inventories, profitability and liquidity**Chapter revision**

Weblinks:

- Internal controls (p.297)
- International Accounting Day (p.297)
- illion (p.307)
- Barcodes Australia (p.317)
- GS1 Australia (p.317)



 Nelson MindTap

To access resources above, visit
cengage.com.au/nelsonmindtap

Nature and importance of internal controls

To control means to guide, to supervise, to keep moving in the intended direction.

Internal control of a business enterprise involves those internal methods and measures that ensure efficient management of the enterprise and achievement of planned objectives.

Internal control is therefore a very important element of accounting, helping to achieve the objective of providing accurate and timely information for decision making and assisting in discharging accountability. When a business is small, the owner can effectively control almost all aspects of the business. As it grows, control by the owner becomes more difficult, necessitating greater reliance on employees. Many large employers hire internal auditors to ensure that management controls are adhered to.

The general aims of internal control are to:

- safeguard the assets of the business
- check the accuracy and reliability of the business's accounting data
- promote operational efficiency
- encourage adherence to prescribed managerial policies.

Thus, internal control is the plan for the organisation and all the methods and procedures adopted by management to ensure that it operates as planned.

There are two types of internal controls:

- accounting controls
- administrative controls.

Accounting controls are the methods and procedures designed to safeguard the assets of the business and to check the accuracy and reliability of its accounting data.

Administrative controls are the methods and procedures designed to promote operational efficiency and to encourage adherence to prescribed managerial policies.

Internal accounting controls and administrative controls

The accountant has many methods and measures to ensure that the general aims of internal control are achieved.

Internal controls built into an accounting system aim to:

- prevent errors from being made in the first instance
- detect errors if they are made
- prevent theft and fraud
- increase efficiency through budgeting procedures.

Internal accounting controls are built around the following seven principles.

1. Reliable, competent personnel

An accounting system is only as good as the individuals who implement and maintain it. Therefore, it is vital for an organisation to employ qualified personnel and to ensure they are given duties and responsibilities commensurate with their abilities. It is also vital that employees realise the importance of adhering to internal control procedures.

2. Verification

Verification is the act of checking the accuracy of accounting records by some independent means. One important way to verify accounting records is to compare the physical asset with the accounting record relating to it. This is often described as comparing 'what is there with what should be there'. A stocktake verifies the business records with the physical stock present. The bank reconciliation process verifies the business's records with the independent bank's records. The trial balance verifies that debits equal credits and, if they do not, then an error has occurred. Another verification technique is to ensure that the work of one person will automatically check the work of another person.

3. Authorisation

Authorisation means that a person in a position of responsibility or authority will validate a course of action. Such things as purchasing assets, granting credit and paying bills all require authorisation. This ensures that only valid data enter the system. All source documents are therefore authorised by appropriate personnel. For example, a purchase order would be signed/electronically verified by an officer with authority to order inventories.

4. Responsibility

The plan of the organisation should assign responsibility for the functions to be performed and confer the authority necessary to carry them out. Responsibility for tasks should not be shared, as this may create problems if queries arise.

Each employee has a defined area of responsibility so that actions can be traced back to the responsible individual if some query arises. Fixing responsibility promotes care and efficiency.

5. Separation of duties/rotation of duties

Separation of duties means the separation of authorisation, recording and custodianship (physical handling of the asset). People who authorise a transaction should not be involved in recording or handling the asset. The person who does the recording of particular assets should not also be responsible for the physical handling of the asset. It is vital that separation of duties be adhered to; fraud is only possible if the person

who obtains the physical asset is also able to change the records to cover the fraud. Where separation of duties is implemented, **two or more people would have to collaborate in order to commit a fraud.**

In addition to separating the duties of personnel, employees should also rotate duties as much as possible and be forced to take annual leave. Often it is only when another person takes over a job that errors caused by carelessness or dishonesty can be detected.

6. Adequate and accurate documents and records

Documents are necessary to capture the information that is to enter the accounting system. Inadequate documentation can cause control problems. Documents ensure that assets are correctly recorded and controlled. Documents should be:

- consecutively numbered to control missing documents and to aid location
- simple in design to ensure accuracy of completion
- prepared simultaneously or as soon as possible after the transaction takes place.

Various devices such as cash registers and barcode readers are used to ensure accuracy of recording. Computer programs also ensure that valid data are entered (valid credit card numbers and inventory numbers, prompting for input, checking for credit limits and so on). Procedures will also be established to ensure accuracy of recording. (For example, a procedures manual sets out procedures to be followed.)

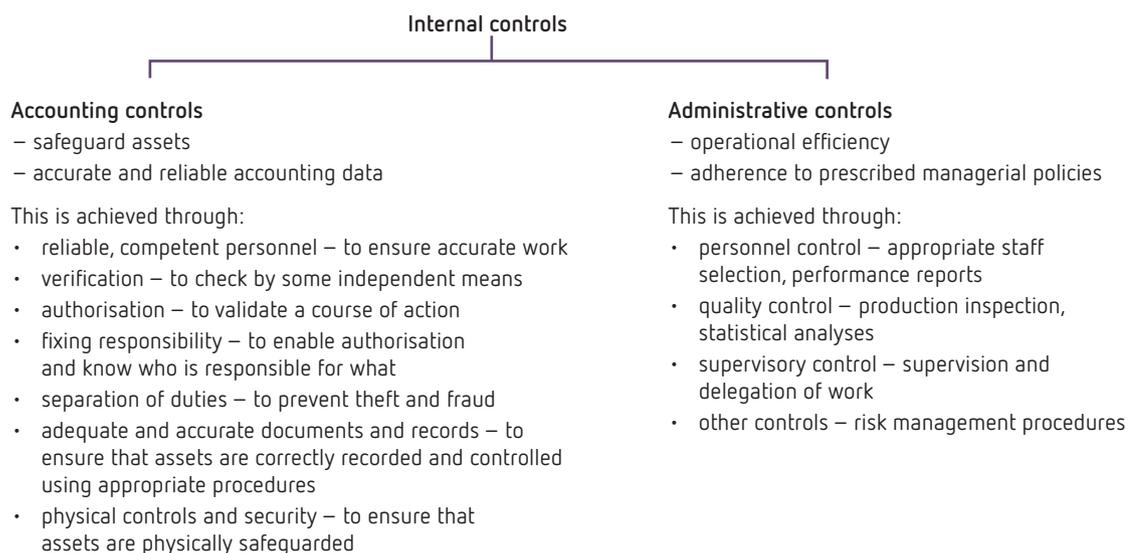
7. Physical controls and security

This principle relates to the controls that physically safeguard the assets, particularly cash, inventories and long-term assets. It includes such things as control over access through keys and employee identification cards, cash registers, safes, secure areas for storage of inventories, video surveillance, after-hours security, fire protection and adequate insurance.

These are the general features of a good system of internal control. The extent of internal controls that are possible and desirable to use will depend on the size of the organisation and other factors such as the nature of the activity and the associated product, size of the business, location and dispersion, management and ownership.

In the rest of this chapter, further applications of these general principles, along with special controls relating to credit transactions and inventories, will be discussed.

Accounting controls are the most important management controls in an organisation. There are, however, other controls that management must implement. The following is a summary of all these internal controls.



Real-world application



Internal controls

Every business needs to establish a good system of internal control. However, many businesses struggle with the concept and what it means. As such, they fail to implement such a system. Follow the weblink and watch the video to ensure you have a good understanding of the concept and its importance.



Weblink
Internal
controls

Interesting accounting fact

Did you know?

International Accounting Day

International Accounting Day is celebrated around the world on 10 November.

Source: Accountants Day.



Weblink
International
Accounting Day

Check for understanding

- 7.1 **a Describe** internal control.
 - b** Why is it necessary for an organisation to have a good system of internal control?
- 7.2 List and **describe** the general principles of a good system of internal control.
- 7.3 **Explain** why it is necessary for the duties of employees to be separated as much as possible. Give examples of where you think this principle can be applied.
- 7.4 The principles of internal control can be easily implemented in large organisations where there are many employees. How can these principles be employed in small organisations, such as a small corner store? Which are easily implemented? Which are harder to implement and how can the problem be overcome?

Control over credit

As was previously stated, adequate controls must be implemented to ensure that the preparation of records is as accurate as possible to minimise theft and fraud. In relation to credit transactions, the following controls apply the general principles (outlined on pages 295–6) that are appropriate, together with special controls relating to accounts receivable (trade debtors) and accounts payable (trade creditors).

Importance of credit

Control over credit is becoming more important because of the tendency to rely less on cash and to use credit cards and credit facilities instead. Many business transactions are carried out on a credit basis, such as the purchasing and selling of inventories. These credit transactions create accounts receivable and payable, and adequate controls must be implemented over them.

Credit transactions

A credit transaction is one that is based on the concept of 'buy now, pay later'. The purchase and sale of inventories and non-current assets such as motor vehicles and plant and machinery are examples of business transactions that are often carried out on a credit basis. In fact, Western society is tending to rely less on cash, using credit transactions and credit cards instead. Credit transactions give rise to the terms 'receivables' and 'payables'.

Receivables (debtors) are amounts that are due to the firm from other businesses or persons. Payables (creditors) are amounts payable by the firm to other businesses or persons.

Receivables can be broken up into two main categories:¹

- Accounts receivable consist of amounts owing to the business for goods and/or services supplied by the business on credit. Because these debts result from the business's trading operations or performance of services, they are sometimes called trade debtors.

These accounts are generally received within a short period of time and are therefore classified as current assets (see page 136). The terms of trade vary from net payment in seven days, to 30 days or the end of the month following the month of the transaction. Some firms allow discounts to encourage prompt payment.

If the debts are expected to be outstanding for longer than one accounting period, they are classified as non-current assets.

- Other receivables consist of amounts owing to the business as a result of the sale of long-term assets, such as motor vehicles and equipment. If these debts are due within one accounting period, they are classified as current assets. Otherwise, they are classified as non-current assets.

Payables can also be broken up into two main categories:²

- Accounts payable consist of amounts owing by the business for goods and/or services supplied to the business on credit. Because these debts result from the business's trading operations or performance of services, they are sometimes called trade creditors. These accounts are generally paid within a short period of time and are therefore classified as current liabilities. If the debts are expected to be outstanding for longer than one accounting period, they are classified as non-current liabilities.
- Other payables consist of amounts owing by the business as a result of the purchase of long-term assets. If these debts are due within one accounting period they are classified as current liabilities. Otherwise, they are classified as non-current liabilities.

This separation of accounts receivable/payable from other receivables/payables allows proper analysis of the position of the firm in relation to profitability and management control over credit.

1 Some firms have another category of receivables called bills receivable. Bills receivable are receivables that have been evidenced by a legal document such as a bill of exchange or a promissory note. These are outside the scope of this book.

2 Some firms have another category of payable called bills payable. Bills payable are payables that have been evidenced by a legal document such as a bill of exchange or a promissory note. These are outside the scope of this book.

Why give credit?

Why do firms sell on credit? Surely it is safer only to sell goods for cash. Most businesses would like to sell goods only for cash and, if they could operate that way, then they most definitely would. However, consider the following:

- Offering credit could increase the amount of overall sales and hence lead to increased profitability. If a business gives people time to pay, they might buy the goods from that business instead of going to another business where they have to pay in cash immediately.
- Competing firms may offer credit facilities to their customers. In order to compete, a firm may be forced to offer credit.
- It is sometimes more convenient to have credit facilities. In many large businesses, the provision of credit allows the separation of duties. The sale of the goods, their delivery and the receipt of the cash are performed by different people. For payment, a bill or statement of account is simply sent to the firm at the end of the month.

The object of providing credit is therefore to increase profitability. The business tries to ensure that the revenue generated by the increased sales that result from the offering of credit is greater than the cost of providing the credit.

However, the costs of providing credit can be quite substantial. These costs include:

- the money lost by allowing discounts for prompt payment. These settlement discounts are an incentive to make people pay early
- staff costs of running a credit facility
- stationery, printing, telephone costs and so on
- the cost of bad debts when an accounts receivable does not pay
- the opportunity cost involved in not receiving the cash immediately. If the business sold \$20 000 worth of goods for cash, then it could be invested at, say, 10 per cent. If the firm allows customers 30 days to pay, then the firm has forgone 10 per cent interest on \$20 000 for one month. This amounts to an opportunity cost of \$167:

$$\$20\,000 \times \frac{10}{100} \times \frac{1}{12} = \$167$$

Many small businesses find it unprofitable to run their own credit facilities and instead offer credit through arrangements such as Visa, MasterCard, American Express, Diners Club and so on. For example, a business would pay Visa a small percentage of its Visa sales. In return, Visa takes over the burden of sending accounts, collecting debts and so on. In this way the business has the advantage of selling on credit but not the tremendous cost of running its own credit department.

Credit/debit cards offered by a bank

One way for a firm to offer credit without the need for its own credit department is to be part of a bank credit card facility. When such facilities (Visa, MasterCard, other similar cards) are offered by banks, this means that the business/merchant receives cash for these transactions almost immediately because the amounts are guaranteed by the banks. The vast majority of credit/debit cards using Visa and MasterCard are offered by banks. Some businesses will brand their own credit cards even though they are backed by banks. At the time of writing this text, Coles had a branded credit card that was issued by National Australia Bank. Why do you think Coles would do this?

Customers are given a credit card that allows them to purchase goods or services up to a set limit. The firm is then charged a fee for the use of the institution's facilities.

When a credit card is read at a merchant's facility, the following will occur:

- The amount of the transaction is entered.
- An electronic check is made to see if the card number is on a 'hot file'. This 'hot file' is a list of cards that have been reported stolen or lost.
- An electronic check is made to see if the card is still current (i.e. not past the expiry date) and determine if the credit limit has been reached.
- Authorisation will then occur by the customer entering a PIN (Personal Identification Number); or if the amount is under a certain limit, then payWave (Visa) or PayPass (MasterCard) can be used by tapping the card and going (tap and go).
- A copy of the credit card voucher is given to the customer.

A debit card is used to directly transfer money. The debit card can therefore be used by customers to pay amounts without carrying cash. A debit card holder authorises the bank to transfer money from the cardholder's account at the bank to the account of the merchant/business selling the good or service. This system is called electronic funds transfer at point of sale (EFTPOS). The controls to be implemented over this type of sale are similar to the credit card above. The amount of the transaction is entered, the customer's card is read, the customer enters the PIN, payWave or PayPass, and the computer decides if the transaction can be processed after checking the hot file, expiry date and balance of the account.

Essentially, both the credit card sales and the debit card sales will appear as one amount in the bank statement. This electronic deposit to the bank of, say, \$9000 will be recorded in the normal way:

Cash at Bank	Dr	\$9 000
Sales	Cr	\$9 000

Each month, the business is charged a fee for operating these cards. The merchant fee is generally based on the cost of the machine and the dollar amount of transactions per month. For example, the EFTPOS machine might cost \$25 per month, an integration fee to link the EFTPOS machine to a Point of Sale system might be \$10 per month, and a fee of 1.2 per cent of the value of Visa, MasterCard and EFTPOS transactions for the month may apply. These fees would appear on the bank statement each month. If there were \$15 in normal bank charges for keeping the transaction account and \$125 in credit/debit card fees, they would be recorded as follows:

Bank Charges	Dr	\$140
Cash at Bank	Cr	\$140

If desired, separate accounts could be kept for each of these fees.

Check for understanding

- 7.5 a **Explain** the meaning of a credit transaction.
- b Gragan Traders has an average of \$50 000 worth of accounts receivable per month. Accounts receivable are offered 2.5 per cent discount if paid within 14 days. Approximately 40 per cent of customers take the discount, with the rest paying within 30 days. The prevailing interest rate is 7 per cent. Other credit expenses for the year are staff costs of \$35 000 and printing, postage, stationery and telephone costs of \$7000.
- i **Calculate** the costs of providing credit for a year in contrast to making cash sales of \$50 000.
- ii By how much must sales increase per annum to cover these costs if Gragan Traders has a gross profit margin of 45 per cent (i.e. profit is 45c for each dollar of sales)?
- 7.6 Numan Suppliers have just written off a debt of \$3000. Given that the gross profit margin is 40 per cent, what value of extra sales must take place to cover the cost of this bad debt?

7.7 Wendy Bravelli has just opened a gift shop in a local shopping centre and is trying to decide whether to operate an electronic bank credit/debit card system for her customers. She notices that many of her competitors in the shopping centre have electronic payment facilities for their customers.

She approaches you as a consultant to determine which of the above systems would be suitable for her needs based on estimated credit/debit card sales of \$175 000 per year. She also would like advice on how to record these types of transactions in her records.

Because you realise that banks are eager to attract new customers, you decide to approach two banks for details of their systems with regard to merchants. (A merchant's view is how the business views the transaction. A consumer's view is how the user of the card views the transaction.) You are interested in finding answers to the following questions:

- How much would it cost to implement the above procedures?
- How are the fees calculated? Does this include the cost of the terminal?
- Can normal telephone lines be used?
- Is one system better than the other for detecting errors and fraud?
- What are the advantages/disadvantages?

Create an extended response to Wendy, outlining the results of your investigations. You should make some recommendations as to a desired course of action. **Explain** clearly the accounting procedures that will be required.

Internal control over accounts receivable

1 Credit approval All customers who apply for credit must be thoroughly investigated for their **creditworthiness**. Such things as permanent employment or length of time in business, amount of income/profit, permanent residence, ability to pay debts, past credit history and credit ratings from other firms must be looked at before credit is given. This investigation is essential because if credit is given to the wrong people, there is an increased risk of bad debts occurring.

The business must have a **credit policy** and must decide the following:

- what the minimum requirements will be before credit is granted
- the number of days given for accounts receivable to pay
- whether or not discounts for early payment (settlement discounts) will be given. Typical terms might be 1/7 N/30, meaning 1 per cent discount if paid in 7 days, net amount payable in 30 days.
- the amount of interest (if any) that will be charged on overdue accounts.

In larger businesses, these functions are generally carried out by a credit department. Credit approval must always be the responsibility of the finance section and not of the sales section. In this way, salespeople are not tempted to adjust a person's credit rating simply to get a sale. When a credit sale is made, it is important that salespeople check the credit status of the potential customer.

2 Recording The use of **control accounts and subsidiary ledgers** in an accounting package is essential. This control occurs through comparison of the Accounts Receivable Listing with the control account in the general ledger. This was discussed on pages 169–78 in Chapter 5.

3 Billing As mentioned in Chapter 4, a **tax invoice** is the main document that certifies a credit sale has taken place. An **adjustment/credit note** certifies that a sales return or allowance has occurred. As well, **statements of account** should be sent at regular intervals to accounts receivable so that cash from these credit sales is collected as soon as possible. A statement of account, shown in Figure 7.1, is simply a list of the transactions (goods sold on credit, cash received and so on) that have occurred, and is in the same form as a three-column ledger.

Blacklock Traders
374 Thomas Street
Melbourne 3000

Date of issue 30 April 2026

Statement

Account no 743657-1

J & R Flinders
76 Johnstone Road
BRISBANE 4000

<i>Payments or returns made after above date will appear on next statement</i>				
Date	Reference	Debit	Credit	Balance
		\$	\$	\$
Apr 4	GDS 13472	167.10		167.10
5	RTN13472		40.05	127.05
16	GDS 27453	860.00		987.05
27	Cash		400.00	587.05

Retain this portion for your records

Send this portion with payment

Remittance advice

Over 60 days	60 days	30 days	Current
0.00	0.00	0.00	587.05

Account Number 743657-1

Account Name J & R FLINDERS

Amount payable

\$587.05

31 May 2026

Due date

Figure 7.1 Statement of account

Statements of account also help to ensure that the business's records are correct, as most people receiving an incorrect statement will contact the firm. This, in conjunction with spot checks made by the accountant or internal auditor to see that statements of account agree with actual accounts receivable balances, help ensure that the business's accounting records are accurate.

If there are a large number of accounts receivable, a technique called **cycle billing** may be used. Instead of sending out all accounts receivable at the end of each month and having a very heavy workload at that time, cycle billing spreads this workload over the whole month. Customers are grouped alphabetically and statements are sent out in a cycle during the month. For example, statements for accounts receivable whose names start with A–F will be sent out on the first day of every month, G–L on the 8th, M–S on the 15th and T–Z on the 22nd.

4 Reporting Each accounts receivable must be monitored to ensure that debts are paid on time. The most common technique used is called ‘ageing the accounts receivable’.

An Aged Receivables report is prepared, normally generated by an accounting package, setting out the age of each account as 0–30 days, 31–60 days, 61–90 days and over 90 days. An example is shown in Figure 7.2.

Aged Receivables as at 30 April 2026						
Blacklock Traders 374 Thomas St BRISBANE Q 4000						
Name	Credit Limit	Total Due	0–30	31–60	61–90	90+
Ambercic Ltd	8 000.00	5 389.21	5 389.21	0.00	0.00	0.00
Canjon & Co	0.00	1 932.00	0.00	0.00	0.00	1 932.00
Famechon Motors	1 000.00	487.00	487.00	0.00	0.00	0.00
J & R Flinders	1 000.00	587.05	587.05	0.00	0.00	0.00
K Moon	1 000.00	512.34	0.00	512.34	0.00	0.00
Park Travel	0.00	1 755.00	0.00	0.00	1 755.00	0.00
Zhung Pty Ltd	5 000.00	4 200.65	4 200.65	0.00	0.00	0.00
Total:		\$14 863.25	\$10 663.91	\$512.34	\$1 755.00	\$1 932.00
Ageing per cent:		100.00%	71.75%	3.45%	11.80%	13.00%

Figure 7.2 Aged Receivables report

This report identifies slow-paying customers so that appropriate action can be taken. The older the debt, the less likely it is that the account will be paid. Accounts receivable must therefore be constantly reminded of the debt. Generally, accounts receivable are contacted by telephone, and/or reminder notices (varying in degrees of tact) are sent with overdue accounts. For example, the first reminder may say, ‘Perhaps you have overlooked this account. Please pay promptly.’ The final letter may say, ‘If payment is not received within 21 days, court action will be taken.’

If all procedures (including placing the matter in the hands of a debt collection agency) fail to collect the money owing, the account may have to be written off as a bad debt.

Communication



Report

Purpose

Reports are formal means of business communication. They should present facts and/or ideas as accurately, clearly and concisely as possible. This may involve incorporation of graphs, diagrams and illustrations to help the users obtain the most benefit from the information presented.

Features of a good report are appropriate headings, timeliness, accuracy, simplicity, consistency and clear presentation. They must comply with accounting standards and the law.

Reports may be prepared for internal users (managers, supervisors) or external users (shareholders, creditors, government departments and so on.)

How information is communicated

Setout: Short reports

Heading (title)	Subject of the report.
Introduction	Statement of what is being reported upon. This may include an explanation of how data were collected.
Main text – body	Detailed and logical presentation of facts. Subheadings used where appropriate.
Conclusion	Inform the reader of the decision arrived at as a result of considering the information outlined in the main text.
Recommendations	Where required, a list of recommendations would be given.
Signature and title	Person preparing the report signs. Position in firm is also given.

Setout: Long reports

Front	Cover; title page (title of report, author's name, date of report); table of contents; summary of report.
Content	Same format as a short report, but could be more detailed and is more likely to include sectional numbering of paragraphs.
Back	Appendix, bibliography/references.

Providing the financial statements were prepared consistently from period to period, a written report can be prepared to assist interpretation of these results. An appropriate report analysing and interpreting the financial statements could include:

- **title** and **date** of the report
- **introduction** – sets out the scope and purpose, and conditions in which the report was prepared
- **main text** – if appropriate, headings may be used. (In each of these areas, comparisons would be made with past years and with industry averages, noting any evident trends. In the profitability area, it may be wise to compare returns with those from alternative investments, such as government bonds, where there is virtually no risk. In the written report it would be acceptable to round figures such as numbers of days to more meaningful whole figures.)
- **conclusion** – summarises key points and makes conclusions as to management effectiveness
- **recommendations** – recommendations for action
- **signature** and position of the preparer.

Now let us prepare a report to Blacklock Traders based on an analysis of the Aged Receivables.

REPORT TO BLACKLOCK TRADERS

3 May 2026

Re Analysis of Aged Receivables

I have examined the Aged Receivables for Blacklock Traders as at 30 April 2026. This report is an analysis of these receivables.

FACTS

Of the total \$14 863.25 accounts receivable, \$10 663.91 or 71.75 per cent are currently within the normal 30-day period. Only \$512.34 or 3.45 per cent are slightly overdue up to the 60-day period. However the other two accounts receivable, representing an outstanding amount of \$3687 or nearly 25 per cent of the total, are quite troubling.

CONCLUSION

Having 25 per cent of accounts receivable outstanding over 60 days is a great concern. It is good that you have reduced their credit limit to zero (0) and you are no longer selling to them.

RECOMMENDATIONS

I presume you have already sent letters to both Canjon & Co and Park Travel about these debts.

I recommend telephoning these accounts receivable. This is much more effective than sending letters. If you have no success, then perhaps the manager will have to personally visit these businesses to see what the problem is.

One option could include part payments over 3 or more instalments. Another is obtaining the services of a debt collector. However, writing these debts off as bad should be the last resort.

I also recommend you review your credit procedures. Perhaps you are giving credit to the wrong businesses. Measures should be taken to strengthen these procedures with a much stricter credit policy being implemented. A careful watch must be kept on who is given credit in the future.

Brit Murgart CPA

5 Separation of duties This is a very important principle of internal control. No person who handles the physical assets of cash or inventories should also have access to the accounts receivable records. This is to ensure that assets are not removed illegally and the records adjusted to cover up the fraud.

Internal control over accounts payable

1 Proper authorisation This should be obtained before goods are ordered. Suppliers should be approved on the basis of price, quality and the ability to fill orders on time. The business should try to have access to two or more sources for as many goods as possible.

Proper authorisation must also be obtained before payments are made. This ensures that each accounts payable is paid the correct amount.

2 Recording The use of **control accounts and subsidiary ledgers** in an accounting package is essential. This allows greater control through comparison of the control account in the general ledger with the Accounts Payable Listing. This was discussed on pages 169–73 in Chapter 5.

3 Prompt payment Procedures should be implemented to ensure that payments are made promptly, especially within any discount periods. This means that the business takes advantage of any discounts and maintains its reputation for prompt payments.

4 Separation of duties People who handle the accounts payable records should not handle the payment of cash or the receipt of inventories.

Greater control over accounts payable is achieved by creating an accounts payable account for all accounts owing (including expenses such as rates, electricity and phone) when the statement of account is received or when it is known that money is owed. When a statement is received for payment, instead of just paying the expense on the due date, an entry is made immediately to record the liability. For example, if on 1 June an electricity account was received for \$550 (including GST), to be paid by 15 June, this would be recorded as follows:

General Journal				
Date	Particulars	Ref	Dr \$	Cr \$
June 1	Electricity Expense GST Credits Received Accounts Payable – Electricity Co (Received account from Electricity Co)		500 50	550

When the account is paid on 15 June, the following entry would be made:

General Journal				
Date	Particulars	Ref	Dr \$	Cr \$
June 15	Accounts Payable – Electricity Co Cash at Bank (Paid electricity account)		550	550

The result is the same regardless of whether or not the liability is recorded at the beginning (as Electricity Dr, Cash at Bank Cr). However, greater control is achieved because the amount owing is recorded immediately and cannot go astray. The normal checking processes would then occur to verify the payment before it is made.

Corporate credit cards

These cards allow employees to make legitimate credit purchases on behalf of the business. Control must be kept over these cards to ensure that they are used only by authorised people and only for business purposes. Verification of these expenses will be carried out before payment is made.

Real-world application



Brisbane City Council sacks senior bureaucrat, implements changes over \$450,000 fraud

By Josh Bavas

Brisbane City Council has sacked its chief internal auditor and is introducing a raft of new measures to ensure it does not fall victim to another fraud in the future.

Deloitte delivered its findings to council on Wednesday after Lord Mayor Graham Quirk ordered an independent report be conducted.

About \$450,900 was lost when fraudsters mimicked invoices of a real contractor, tricking council staff into paying them tens of thousands of dollars in nine instalments in July and August this year.

Cr Quirk said while no council staff were behind the scam, there could have been better processes in place to detect it.

'This case was much more than the result of simple human error,' he said.

'This sophisticated fraud has taken advantage of a loophole in council's processes, where the procedures were not effectively managing changes to supplier payment information.'

Police were able to retrieve about \$42,200 after freezing the bank account of the alleged criminals.

But Cr Quirk said while investigations were continuing, it was unlikely any more would be recovered.

'We'll be taking our learning to the small and medium businesses out there as well to just be extra cautious in terms of your dealings. You never know when a fraud may occur,' he said.

Some of the recommendations include implementing new procedures, staff training and more clearly defined roles for staff involved in management of supplier payment information.

Source: *ABC News*, 30 September 2016. Reproduced by permission of the Australian Broadcasting Corporation - Library Sales © 2016 ABC. <https://www.abc.net.au/news/2016-09-30/brisbane-council-sacks-senior-bureaucrat-over-fraud/7891042>

Check for understanding

- 7.8 Briefly **explain** several major features of an effective system of internal control over accounts receivable and accounts payable.
- 7.9 Visit the website of illion, which was formerly known as Dun & Bradstreet Australia.



Weblink
illion

Source: illion Australia Pty Ltd

- Click on About Us and briefly **explain** the business of illion.
- What personal products are available to help people obtain credit?
- What business products are available to help organisations minimise the risk of giving credit?

7.10 Read the following article called *That Magic Number*, which has been reproduced from *The Courier Mail*

That Magic Number

Money

A credit score plays a key role in lenders deciding whether you can borrow money, and many Australians don't realise it can also deliver them lower interest rates and better loan deals.

Fewer than one-third of consumers know their credit score, and about half have never seen their file despite the fact that it costs nothing to obtain.

Almost one quarter (23 per cent) of borrowers have used their score to get a better deal on a loan, according to new research from finance platform SocietyOne, which was recently acquired by digital lender MONEYME.

"When applying for credit, the amount you can borrow and the rate applied to your loan often depends partially on your credit score," says MONEYME chief operating officer Jonathan Chan.

"Engagement with your score and overall finances can help you to improve your finances overall, whether that be by getting a better deal on a loan, or creating good financial habits," he says.

Better System

Credit scores have become more accurate and detailed in recent years with the introduction of Australia's comprehensive credit reporting system, which measures both positive and negative credit events rather than the historical negative-only approach.

Several lenders offer tiered interest rates based on people's credit scores, and rate differences can be 5 per cent or more.

The Australian Securities and Investments Commission's Moneysmart.gov.au service says people can access their credit score, also known as a credit rating or credit report, at no charge.

Moneysmart says it usually takes a day or two via an online request, or you may have to wait up to 10 days if you want it mailed.

"You have a right to get a copy of your credit report for free every three months," it says. "It's worth getting a copy at least once a year." People can access their score through credit reporting agencies Experian, illion and Equifax, it says. Scores are between zero and 1000 or 1200, depending on the agency.

Experian general manager of credit services Tristan Taylor says more than 95 per cent of Australians' loan accounts are reported within the comprehensive credit reporting system, allowing lenders to get a "complete picture of an applicant's financial history and behaviours".

Boost Your Score

"While improving your credit score takes time and careful management, there are ways people can proactively manage the health of it," Taylor says.

"Keeping on top of your repayments and choosing the right financial products for your situation are important factors in maintaining a strong credit score.

"Tips on how to improve credit scores can be found at CreditSmart, an industry initiative developed by credit experts to help Australians understand how credit reporting works and how to look after credit health." Kurt Phipps, 30, is looking to buy real estate so he checked his credit score in advance.

"I wanted to better understand my financial situation including if there was anything I could do to improve my borrowing power," he says.

His credit report also provided insights about how he could improve his score. "This knowledge has allowed me to gamify improving my finances, incentivising me to see how high I can lift my score,"

Credit score influences

- The type of lender you have applied to.
- How well you've kept up with your repayments.
- The credit limit of each of your credit products.
- The type of product you have applied for.
- The number of credit applications you make.
- Negative events, such as defaults, judgments or bankruptcies

- a In your own words, **explain** the nature of a credit score.
- b **Identify** the 3 major credit reporting agencies in Australia. Find their website, add to Favourites and print the link so you can look at it at a later date.
- c Visit the websites of moneysmart.gov.au and CreditSmart. Add to Favourites and print their link. What information is available there?
- d What other items might a lender consider besides the credit score?
- e Discuss this article and its concepts with your parents and siblings. Did they know what their credit score was?
- 7.11 a Austran Industries has decided to introduce cycle billing. As the assistant accountant, you are required to draft an email to be sent to all staff in the accounting department outlining the operation and benefits of cycle billing.
- b **Analyse** the information shown in the ageing of accounts receivable for Funstan Trading on the next page and complete the following:
- i Who is the largest accounts receivable?
 - ii Why don't some accounts receivable have a credit limit?
 - iii **Create** a letter to Munnt Bros outlining how you feel about this debt. The business has received regular statements of account and has not paid its debt.
 - iv Would you continue selling goods to Lamont Industries? Why? Compare this with Nummins Enterprises.
 - v Assuming that the terms of trade are 30 days, is the pattern of payment displayed by the accounts receivable acceptable? What would you try to do to improve this pattern?

Funstan Trading							
Ageing of Accounts Receivable as at 30 September							
Customer	Credit limit	Balance due	Current	30 days	60 days	90 days	Over 90 days
	\$	\$	\$	\$	\$	\$	\$
Blacklock Traders	10 000	3 000	1 200	1 800			
Harper J	3 000	150	150				
Jackson V	5 000	2 309	2 309				
Lamont Industries	5 000	4 301	1 201	1 293	1 807		
Mullins B		685				685	
Munnt Bros		542					542
Nowles B	1 000	125	125				
Nummins Enterprises		1 789			1 789		
Westmead Industries	5 000	1 000	347	653			
Total due		\$13 901	\$5 332	\$3 746	\$3 596	\$685	\$542
% of total due			38.4%	26.9%	25.9%	4.9%	3.9%

7.12 The following details of outstanding accounts receivable are available at 30 April:

Accounts receivable	Credit limit	Amount of debt	Days overdue
	\$	\$	
Brandon Ltd	20 000	14 500	30
J & B Williams	5 000	1 200	Current
Adams & Sons	8 000	6 800	60
K Bryan	1 000	600	30
T C Band Ltd	1 000	300	90
Norman Pty Ltd	1 000	700	Current
Manor Gring	1 000	100	Current

- a **Prepare** an ageing of accounts receivable report similar to that on page 303.
- b **Interpret** this report, given that the terms of credit are normally 30 days.
- c Design stickers for accounts that are 30 and 60 days overdue. These stickers will be attached to statements of account to get the message across that payment would be greatly appreciated.
- d **Prepare** a letter that could be sent to accounts that are 90 days overdue.

Control over inventories

Importance of inventories

Inventories are important for several reasons:

- They are an integral part of profit determination. They are used in calculating any inventory adjustment to be included in cost of goods sold and therefore have a great bearing on the profit figure.

$$\text{Gross profit} = \text{Sales} - \text{Cost of goods sold}$$

- A figure for closing inventories must be obtained so that the Statement of Financial Position can be accurately prepared. Closing inventories are one of the items of value owned on balance day. Indeed, inventories are often one of the larger items in the asset section of the Statement of Financial Position.
- Inventories should be turned over as quickly as possible. The faster the turnover (sales), the greater the opportunity to make profits.
- Because large amounts of money are invested in inventories, adequate controls must be implemented so that theft and other losses are kept to a minimum. Store cameras, store detectives, inspection of shopping bags and curved mirrors are methods used to prevent theft by customers.
- The quantity of inventories must be continually monitored. Neither too many nor too few inventories should be kept on hand. Problems in this area can lead to **stockouts**, where the business runs out of stock, or **overstocking**, where the business has too much stock.

If the level of inventories held by the business is too high and goods are not selling, then money is being tied up and not being used to generate profit. This is why many businesses have a clearance sale – to reduce the price and convert slow-moving inventories to cash so that faster-moving inventories can be purchased.

If the level of inventories held by the business is too low, sales will be lost to competitors and goodwill will diminish.

- The quality and type of the inventories are very important. The business should try to have available for sale the right goods, at the right place and time. A constant check must be made to ensure that inventories are not out of date, the wrong colour or size, or of poor quality, otherwise sales will suffer.

The procedures for controlling inventories will depend on the size of the business:

- If the business is large, these functions are shared between different departments, and internal controls must be built into the system.
- If the business is small, each of the functions could be performed and supervised by the owner so that control measures are more easily implemented.

Check for understanding

- 7.13
- Explain** why inventories are so important.
 - Explain** the reasoning behind having ‘the right goods, at the right place, at the right time’.
 - Do you think it is reasonable that businesses implement measures such as inspecting shopping bags? Why or why not?
 - Who eventually pays for losses by theft? Why?
 - Why should inventories be controlled so that neither too many nor too few are held?
-

Stocktaking (physical stocktake or physical inventory)

If a business keeps inventories as part of its normal operations, an annual physical **stocktake** is a necessity.

Stocktaking is the process of listing, counting and valuing unsold inventories on hand.

A stocktake is necessary for two main reasons:

- It is needed to determine the value of the inventories on hand at a particular date. This value is used in the Statement of Financial Position.
- It is the only way of determining actual inventories on hand. If the perpetual inventory system is used, the figure arrived at can also be compared with what should have been on hand. It can then be seen whether goods have been lost through theft or spoilage.

Stocktaking is therefore an important phase of the accounting cycle. In many businesses, it is a long and tedious job that stretches over several weeks and often involves overtime and extra staff. Despite this, every care should be taken to ensure that the results obtained from it are as accurate as possible. Because of the great need for accuracy, the entire procedure should be double-checked and supervised by a member of the accounting department.

The normal procedure in preparing a stocktake is as follows:

- 1 Inventories are arranged in a manner that makes counting as simple as possible. This involves putting all like items together.
- 2 An Inventory Stocktake Sheet is used to record all the details of the stocktake. These sheets are prepared before the stock count, and all known items are listed in the description column with an appropriate stock number. For control purposes, all sheets are serially numbered.
- 3 At a designated time, employees physically count all inventories. For control purposes, it is important to arrange staff so that those people who normally have access to the stored inventories do not count them without supervision. If, during the physical count, inventories are found that are not listed, they are simply added to the end. The actual amounts counted are entered in the number of units on hand column.
- 4 The remaining two columns concerning cost prices may be completed by responsible departmental staff or sent to the accounting department. The prices can be obtained from tax invoices, cost price lists or computer records.

An example of an Inventory Stocktake Sheet looks is shown in Figure 7.3.

Inventory Stocktake Sheet						Sheet no 1
30 June 2026						
Stock no.	Description	Unit of count	No. of units on hand	Unit cost price	Total value	
1014 A	SLX Drill	each	6	87.00	522.00	
1027 C	Cement	bag	152	12.50	1 900.00	
1156 C	2.5 cm nails	500 g	21	1.04	21.84	
47 Y	Golf balls	12	74	15.81	1 169.94	
396 Z	Sheets sandpaper	each	7	0.42	2.94	
					<u>\$47 264.19</u>	

Figure 7.3 Inventory Stocktake Sheet

Check for understanding

- 7.14 **Explain** the meaning of the term ‘stocktake’ or ‘physical inventory’.
- 7.15 State the procedures that are necessary to determine the number and cost of inventories on hand by a physical stocktake.
- 7.16 a Why is an annual physical stocktake a necessity?
b What businesses would not require a stocktake?
-

Real-world application



Stocktake

At the canteen in your educational institution, there are inventories left over at the end of every day. Arrange with the canteen supervisor to count the inventories that are on hand at the end of a particular day.

- Prior to the stocktake, prepare Inventory Stocktake Sheets and list all individual items of inventories that could be on hand.
- On the day of the stocktake, count the stock and enter the quantity on hand in the number of units on hand column for each item.
- After the stocktake, either obtain the real unit costs of each item or ask the canteen supervisor to help you estimate the costs.
- Calculate the total value of the inventories on hand.

Internal control over the purchase of inventories

- The ordering of goods is dependent upon three factors:
 - the **reorder point**, which is a predetermined minimum amount of an item that a business would like to maintain
 - the **reorder quantity**, which is the quantity to be ordered when the reorder point is reached
 - the **lead time**, which is the amount of time it takes from when a business places an order to when the product actually arrives. This is dependent upon how quickly the goods can be supplied and transported to the business.

Generally, the longer the lead time (if, for example, the goods have to come from overseas), the higher the reorder point and the reorder quantity. The shorter the lead time (if, for example, the supplier is in the same city), the lower the reorder point and the reorder quantity.

- When the goods are ordered, a **purchase order** or an **order form** (see Figure 7.4) is despatched to the supplier.
- When the goods are received, a **delivery docket** or **despatch docket** will accompany the goods. Care must be taken to ensure that the goods received are in fact the goods ordered.

- A **tax invoice** may be received at the time of delivery or at a later date (see page 116).
- If goods are returned by us (purchases returns), an **adjustment/credit note** will be received (see page 118).

The use of **control accounts** and **subsidiary ledgers** in an accounting package is essential. This allows greater control through comparison of the control account in the general ledger with the Inventory Item Listing. As discussed on pages 182–91 in Chapter 5, physical movements of stock items in and out are recorded in the subsidiary ledger comprising a Stock Item (similar to an enhanced columnar ledger account). There will be a Stock Item record for every item of stock and every item will have a bar code to make the movement easier to record. The weighted average cost method is generally used and this is how the cost of goods sold figure for every sale is determined. Computers are essential to be able to keep track of the movements and the calculations.

96 Farah Street Brisbane 4000		Williams & Sons		Purchase order No 274
		To Allsports Manufacturing Co 75 Bendall Road Melbourne 3000		Date 19 July 2026
Please supply the following goods and charge to our account				
Quantity	Product no	Description	Unit price	Amount
20	34721	Squash racquets	\$80	\$1600
Terms 1/7 N/30				
Delivery required by 26 July 2026			Per	-----

Figure 7.4 Purchase order

Internal control over the sale of inventories

- Orders may be received over the counter, by post, by telephone, from travelling salespeople, or electronically from a website or by electronic data interchange (EDI). EDI is used by organisations such as Woolworths, Big W, Coles, Aldi, Myer, David Jones, Bunnings Warehouse, Officeworks, The Good Guys, JB Hi-Fi, Harvey Norman, Kmart and Target to name a few. If suppliers want to sell to these organisations, they must use EDI.
- If orders are not received electronically, they are generally entered onto a standardised **sales order** to be processed by the organisation. This is done so that every order to be filled looks the same and has a sales order number for reference.
- If there is no stock on hand to fill the order, then those unfilled stock items are placed on **back order** and will be filled when the stock arrives.
- If there is stock to fill the order, a **picking list** is generated. A picking list is like a normal shopping list. The picker will pick the goods from the shelves and prepare them to be despatched.
- When the order is filled, the details of the transaction are recorded on a **tax invoice** and a **despatch docket**. The despatch docket will accompany the goods and will be signed by the recipient to indicate that the goods have been received. This is important, as it proves that the goods have been delivered and the revenue can be recognised. The tax invoice can accompany the goods or be sent later. Copies of both documents are kept by the seller.
- If the buyer returns goods (sales returns), the seller sends an **adjustment/credit note** and retains a copy.
- A **statement of account** is sent so the buyer knows how much is owed.
- If goods are sold for cash, a **cash register summary** is generally used.

The flow of documents between buyer and seller is shown in Figure 7.5.

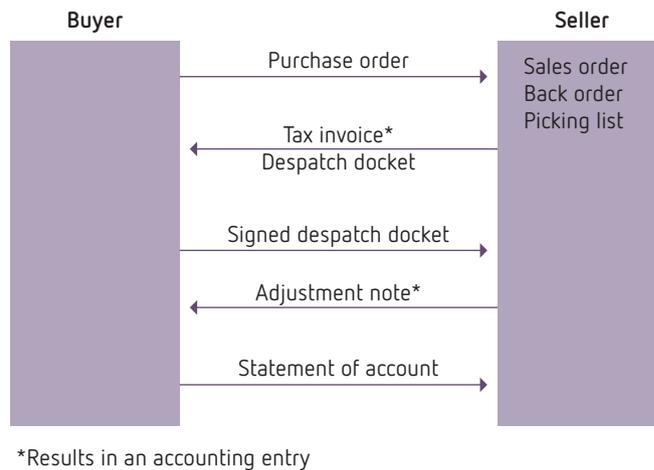


Figure 7.5 Document flows for the purchase and sale of goods on credit

Check for understanding

7.17 **Explain** the following terms in relation to inventories:

- reorder point
- reorder quantity
- lead time.

7.18 With regard to purchasing inventories, **describe** the purpose of each of the following documents:

- purchase order
- tax invoice
- delivery docket
- adjustment note.

7.19 With regard to selling inventories, **describe** the purpose of each of the following documents:

- standardised sales order
- despatch or delivery docket
- tax invoice
- adjustment note.

7.20 Why are tax invoices and adjustment notes important documents in controlling inventories?

Internal control over stored inventories

Because inventories represent such a large investment by the business, losses through theft, damage, deterioration or obsolescence lead to lower sales and thus to lower profit. Adequate controls must therefore be implemented. These controls are generally exercised over location, security and turnover.

Location

- Inventories should be warehoused where they are readily accessible by those people authorised to handle them. Also, for ease of location, inventories of a similar nature should be stored together (in bins, shelves or trays).
- In a retail situation, the goods should be displayed in the most appropriate way in order to maximise exposure but minimise the risk of loss through theft.

Security

- The warehouse must be locked, and only authorised personnel should have access to the keys. Burglar alarms and adequate security staff should be employed.
- Appropriate documentation must be completed when inventories enter and leave the warehouse.
- In a retail store, various measures can be adopted to stop pilfering by staff and shoplifting by customers. They include bag inspections, video cameras, dye markers and store detectives.
- Inventories must be adequately insured.

Turnover

- Inventories should be turned over as quickly as possible. The faster the turnover (sales), the greater the opportunity to make profits. Turnover of inventories is calculated as:

$$\frac{\text{Cost of goods sold}}{\text{Average inventories}}$$

This formula will be discussed further in Chapter 8.

- It is vital that measures are taken to ensure that items purchased first are sold first. In this way, inventories will be rolled over and old stock will not be left standing on shelves or lying at the bottom of bins.
- A minimum of one stocktake must be taken each year and frequent spot checks should be encouraged. Stocktakes determine the amount and condition of inventories on hand. They help to detect slow-moving inventories and those that are out of date or damaged. If the business considers it necessary, steps may have to be taken to dispose of unsuitable inventories. For example, the business might have a clearance sale and sell those items at a reduced price.

Check for understanding

7.21 **Explain** the risks involved if there is inadequate control over stored inventories.

7.22 For each of the following measures, **decide** whether it is control over:

- i purchase of inventories
- ii sale of inventories
- iii storage of inventories.
 - a Premises are randomly patrolled by security staff.
 - b As garments are taken to change rooms, numbered tags are given to customers to show the number of garments taken.
 - c A cash register docket is given to all customers for every cash sale.
 - d Video cameras are installed throughout the premises.
 - e All goods that are received must be checked and signed for.
 - f Customers must show bags of an appropriate size to staff on leaving the store.
 - g In a watch and jewellery store, staff are issued with keys to cabinets that display expensive items.
 - h In order to stop 'ramming', large metal posts are erected in front of glass shop windows.
 - i 'Staff only' signs are erected outside storage areas to discourage customers from entering.

Real-world application



Inventory control using barcodes

Because of the efficiency of computers, businesses are using barcodes to control and account for inventories. This can be seen in the following situations involving retail sales:

- All items in the retail store are given a number, which is marked on the price tag. Generally, these numbers are in the form of a barcode. If the store is a supermarket, a Universal Product Code (UPC), European Article Number (EAN) or Global Trade Item Number (GTIN) will automatically be printed on the product by the manufacturer. The bars are a coded form of numbers. The two numbers on the far left indicate the country of origin (93 is Australia). The next five digits represent the manufacturer or processor, and the next five identify the specific product. The last digit is a check digit.



- The price of every item in the store is stored in the computer and can be altered at any time to take into account price increases and store specials.
 - To record the sale of any item, the number is entered or read by a barcode scanner. The computer finds the price for that product from the data files, and a description of the item and its selling price is recorded on the cash register docket in a matter of seconds. Cost price information for accounting records is automatically processed using the perpetual system.
 - If, because of the sale, the quantity of items on hand reaches the reorder point, the computer will automatically produce a report showing the goods and the quantity of those goods to be reordered.
 - Management will view the report and adjust the orders in the light of future expectations. The computer will then prepare purchase orders for the items of inventory.
 - These purchase orders are sent to the supplier.
- Visit the Barcodes Australia and the GS1 Australia websites for more information.



Weblinks
Barcodes Australia

GS1 Australia

7.23 Look in your pantry at home and find five different products with different barcodes according to the first two digits

- List the products, their barcode and their country of origin.
- What is the most common country of origin?

7.24 Wendy Smithson runs a small boutique. She has always had a policy of not accepting credit cards, because she feels the approximately 3 per cent fee is too high. She is just surviving with her cash-only policy, so credit card transaction fees are an additional expense she doesn't feel she can afford.

However, she has noticed over the past few years that many of her competitors have credit facilities and some customers seem to be reluctant to pay in cash. She now feels that she is starting to lose custom because of her cash-only policy.

She asks you to **analyse** her books and to help her decide whether she should:

- a stick with her present cash-only policy
- b offer credit card facilities
- c offer her own credit facilities.

Her cash sales for the previous year were \$300 000. If she stays with her present policy, she expects her sales to increase by 10 per cent for the year. If she offers credit, she expects sales to increase by a further \$25 000 over and above her cash sales increase.

If she were to offer her own credit facilities, you estimate the following expenses:

Part-time clerk	\$1 200
Administration costs	\$450
Bad debts	\$1 000
Collection agency costs	\$600
Screening of customer costs	\$500

The current rate of interest for investments is 7 per cent.

Advise Wendy as to which option she should choose. Are there any qualitative considerations that should be taken into account?

7.25 'Offering credit is a necessary part of a modern business.' **Analyse** this statement and **create** a paragraph(s) giving reasons for your agreement or disagreement.

7.26 What internal controls would help protect against the following threats?

- a A fictitious statement of account arrives and is paid.
- b A customer's account is written off as a bad debt in order to conceal the theft of money paid by the customer.
- c A supplier's invoice overcharges for the items delivered.
- d Inventories are stolen from the warehouse.
- e Inventories are stolen at a self-service checkout.

7.27 Copy and complete the following tables.

- a Control of accounts receivable

Possible problems	Appropriate controls
Sales lost due to excessively tight credit policies and customers going to other suppliers	
Customers who have been granted credit not paying, or paying late, because of lack of funds, fraud, bankruptcy or liquidation of their business	
Goods and services being delivered but not properly charged or paid for, due to poor recordkeeping or fraud by customers or employees	

b Control of inventories

Possible problems	Appropriate controls
Inventory shortages due to poor planning, poor purchasing, poor recordkeeping, unexpected demand, unavailability from suppliers or theft by employees or outsiders	
Damage to inventory through poor handling or storage	
Poor identification of inventory items, which may then be shipped incorrectly, or left to deteriorate	
Overvaluation of inventory (and profits), because it has become obsolete, has deteriorated or is excess to requirements, so its true market value is less than cost	

Credit, inventories, profitability and liquidity

Business decisions are generally made on the basis of profit. There can be other influencing factors such as the environment, climate change, etc. However, if a business makes continuous losses, then it will fail. Therefore, the profit motive is very important if you are in business, especially if you are in the start-up phase of a beginning business. You must understand the important relationship between profitability (making a profit) and liquidity (the effect on cash assets).

The ultimate aim is to sell goods or services for cash. When a sale is made, cash immediately increases. There is no time delay between the sale and the receipt of cash.

However, if a sale is made on credit (sell now, pay later), then there is a time delay. The normal terms of trade are 30 days. In some businesses, like groceries that have very low profit margins, 3 or 7 days might be given for customers to pay. Using the normal 30-day terms, if a business sells goods on credit, the sales and accounts receivable accounts increase immediately. Profit, therefore, immediately increases but liquidity does not change. The business must have enough cash to pay wages, rent and all the other typical expenses for the next 30 days until the cash for that credit sale comes through 30 days later.

Not only that, but the inventories sold might have been bought for cash just 5 days earlier. We have purchased those inventories and paid for them almost immediately. Our cash has gone down by the amount of the inventories we have purchased. So not only do we have to wait 30 days for the money to come in from the credit sale, but we also have less money to pay our other expenses as we have paid for those inventories as well. Buying for cash and selling on credit has a tremendous strain on liquidity even though our profitability has increased by the amount of the sale less the cost of those goods that were sold.

What if we had purchased those inventories on credit for 30 days? This means that the money to pay for those inventories is required only 5 days before the money coming in from the credit sale. This credit purchase, therefore, has less effect on liquidity than a cash purchase, but the profitability is the same.

If you are selling on credit, your strategy might also be to try and buy on credit. This places less strain on liquidity. As well, many businesses try to negotiate long credit terms (e.g. 30 or 45 days) when they are buying and short credit terms (e.g. 21 or 30 days) when they are selling. This considerably eases liquidity. The problem is that all businesses are trying to do this, so it cannot always be achieved.

In summary, when making decisions about credit and inventories, you must always look at the effect of the decision on both liquidity and profitability.

Check for understanding

7.28 You run a business called Haven Quality Spas. You have a range of spas to sell but your top-of-the-range item is the popular Relaxa Spa. At the moment, you have two of these Relaxa Spas in stock – one blue and one white. The white spa costs \$5400; while, due to a quantity purchase of other items, the blue spa costs only \$4300. Because these models are popular, you decide to place a selling price of \$7000 on both of them. The cost price of each stock item is shown on the price tag in code so that all salespeople know the gross profit margin of each item.

Two sales assistants approach you. They have a customer who is interested in the white spa, but will buy the blue spa if you discount it by \$400. The sales assistants think this is a great idea and, because they have come up with this plan, they think you should give them a bonus of \$200 between them.

- Calculate** the amount of profit that would be made if both spas are sold for \$7000.
- Calculate** the amount of profit on each spa if the blue spa is sold according to the sales assistants' idea and the white spa is sold for \$7000.
- Does the firm make more profit if the sales assistants sell the discounted blue spa rather than the white one?
- Would you accept the sales assistants' plan?

7.29 Quality Appliance Sales has a very good reputation for retailing whitegoods such as refrigerators, stoves, washing machines and so on. When purchasing washing machines from the manufacturer, a minimum order of 10 units is required and the normal purchase price is \$600 per unit, which includes transport costs. The normal terms are that the net amount is payable within 30 days.

Last year the firm sold 80 of this type of washing machine, with sales spread evenly throughout the year. This year, sales of the new model of washing machine are expected to increase by 20 per cent.

You are the accountant for Quality Appliance Sales, and the manufacturer has approached you with the following deal regarding a quantity purchase discount for the new model. If you buy 100 washing machines, the purchase price will drop to \$550 per unit, including transport costs.

The owner has asked you to **create** a written report outlining your recommendation as to whether the firm should accept or reject the offer. **Explain** clearly what advantages and disadvantages result to the firm if the deal is accepted or rejected.

7.30 The aim of this venture is to learn about accounting for a small business venture through producing and marketing a product within your school or local community. Work as a whole class, or in fairly large groups, so that the individual workload is not too large.

Assign jobs to people to suit their abilities. Some students will be able to keep the accounting records and look after the cash and inventory; others will be good at production and catering; some will be good at selling; a few will be needed to fill management positions. You may be able to choose them according to other subjects they do at school.

Obtain a small amount of capital investment for your venture, keep records, and work out beforehand what to do with any profit or loss. Remember: not all businesses succeed. There is some risk involved, so obtain parental and school administration permission for what you want to do.

You will need to consider the ‘four P’s of marketing’ very carefully as part of your business plan:

- **Product:** Consider a small venture to produce a good or a service that can be carried to fruition in a short period of time – such as a cake stall, an ice-cream bar, a car wash or a lamington drive.
- **Place:** Choose the best location for your venture. After obtaining the principal’s permission, remember also to inform or obtain the permission of other people affected, such as the canteen supervisor. They may need to adjust their plans for staffing on the day of your venture.
- **Promotion:** Prepare signs and other advertisements. Consider other forms of promotion, such as free gifts or prizes.
- **Price:** Your product should be competitively priced, with the aim of making a reasonable profit.

Ensure that you keep accurate accounting records of all aspects of the venture and apply all possible control measures for inventory, stock and so on.

After you have finished your small business venture, hold a class discussion to apply what you have learnt to your accounting course. What did you learn about production techniques, use of resources, input costs, consumer demand, pricing, profits, labour–management relations, marketing, accounting and internal controls? Did your venture make a profit? Would it still have made a profit if you had included a realistic amount for wages, rent and other expenses that are normally incurred when running a real business?

CHAPTER REVISION

7.31 Multiple choice

Complete the following multiple-choice questions by choosing the best answer.

- 1 Which of the following is not a general aim of internal control?
 - A Check the accuracy and reliability of accounting data.
 - B Promote employee morale.
 - C Encourage operational efficiency.
 - D Safeguard the assets of the business.
- 2 A physical count of all inventories on hand is carried out at the end of every year. Which of the following internal control principles is in force?
 - A Separation of duties
 - B Reliable personnel
 - C Verification
 - D Responsibility
- 3 Which of the following statements is incorrect?
 - A Accounting controls are the methods and procedures designed to safeguard the assets of the organisation.
 - B Accounting controls are the methods and procedures designed to check the accuracy and reliability of the accounting data.
 - C Administrative controls are the methods and procedures designed to promote operational efficiency.
 - D Administrative controls are the methods and procedures designed to ensure that fraud does not occur.
- 4 Any large purchases of assets will require the approval of a person in authority. Which of the following internal control principles is in force?
 - A Authorisation
 - B Verification
 - C Responsibility
 - D Separation of duties
- 5 The accounting system is designed so that if a major query arises, there is one individual who is answerable. Which of the internal control principles is in force?
 - A Reliable personnel
 - B Authorisation
 - C Separation of duties
 - D Responsibility
- 6 Which of the following internal controls is not an accounting control?
 - A Separation of duties
 - B Product control
 - C Verification
 - D Authorisation
- 7 Which of the following is not a facet of the internal control over inventories?
 - A Internal control over the sale of inventories
 - B Internal control over the price inventories are sold for
 - C Internal control over the purchase of inventories
 - D Internal control over stored inventories
- 8 An important component of internal control over accounts receivable is the adoption of a credit policy. Which of the following would not be a component of a credit policy?
 - A Whether or not discounts are given for early account settlement
 - B The amount of interest (if any) to be charged on overdue accounts
 - C The number of days given for accounts receivable to pay
 - D Whether to use control accounts and subsidiary ledgers when recording accounts receivable
- 9 Which of the following is not a control over accounts receivable?
 - A Sending a statement of account
 - B Preparing an ageing of accounts receivable report
 - C Ensuring prompt payment for our business's purchases in order to obtain discounts
 - D Determining creditworthiness
- 10 When goods are delivered, they must be accompanied by:
 - A a purchase order
 - B a despatch docket
 - C a tax invoice
 - D an adjustment note.

7.32 Case study

STIMULUS 1

You are the accountant for a business called Western Appliances, which sells electrical appliances. Due to increased competition, the manager of the firm is considering offering credit to customers. From your knowledge of accounting, you are trying to determine the best credit policy to recommend to the manager. You realise that if you have a very liberal credit policy, sales will increase dramatically, but so will bad debts. If you adopt a very strict credit policy, sales will not increase as much, but there will be very little problem with bad debts.

STIMULUS 2

On average, Cost of Goods Sold is always 50 per cent of sales.

STIMULUS 3

Scenario 1 is a very liberal credit policy. You estimate that credit sales will increase by \$400 000, but bad debts will be 15 per cent of this. The resultant profit calculation is:

Increased credit sales		\$400 000
Cost of Goods Sold (50% of sales)	\$200 000	
Bad debts (15% of sales)	<u>\$60 000</u>	<u>\$260 000</u>
Increased profit		\$140 000

STIMULUS 4

Scenario 2 is a liberal credit policy, with credit sales increasing by \$350 000 and bad debts of 9 per cent.
Scenario 3 is a moderate credit policy, with credit sales increasing by \$300 000 and bad debts of 2 per cent.
Scenario 4 is a strict credit policy, with credit sales increasing by \$250 000 and bad debts of 1 per cent.
Scenario 5 is a very strict credit policy, with credit sales increasing by \$200 000 and bad debts of 0.05 per cent.

Create a report to your manager outlining the overall problem of setting a credit policy. Using the figures provided in the Stimuli, make a recommendation as to which scenario should be implemented for your firm, but emphasise that these figures are only estimates. To help make the various calculations, you may wish to build a spreadsheet model.

8

PERFORMANCE ANALYSIS OF A SOLE TRADER BUSINESS

LEARNING OBJECTIVES

At the end of this chapter you should be able to:

- describe and calculate the major ratios used to analyse the performance of a sole trader
- explain the relationship between gross profit and net profit
- evaluate, analyse and interpret financial data and information for a sole trader relating to management effectiveness
- create a major report, including the use of graphs, to be presented to a business manager that communicates explanations, analyses and recommendations.

Performance analysis of a sole trader business

Analysis and interpretation of reports

- Vertical analysis
- Ratio analysis

Chapter revision

Weblinks:

- Qantas Airways annual reports (p.337)
- Woolworths Limited annual reports (p.337)



 Nelson MindTap

To access resources above, visit
cengage.com.au/nelsonmindtap

Analysis and interpretation of reports

The accounting system of a firm attempts to provide information for a variety of users. Three general purpose financial reports are usually prepared: the Statement of Profit or Loss, the Statement of Financial Position and the Statement of Cash Flows. These three statements form the cornerstone of financial information that is provided to any interested parties. The role of the accountant and other external users is to analyse and interpret the financial information in order to assist the decision making of various stakeholders. These stakeholders may include outside parties such as investors, or internal users such as owners or managers.

The accountant needs to analyse the data contained in the financial statements in an objective manner, to combine this data with other relevant information and provide some recommendations and observations.

There are a number of tools that can be used to assist in providing data for this analysis. These include:

- vertical analysis
- ratio analysis.

Vertical analysis

Vertical analysis is a technique for evaluating financial statement data that expresses each item in the financial statement as a percentage of a base amount. This analysis moves vertically within the one statement. A key figure is usually chosen – for example, total revenue in the Statement of Profit or Loss – and that is assigned 100 per cent. All items are then expressed as a percentage of that item. In the case of the Statement of Financial Position, the total assets figure is usually assigned 100 per cent. Vertical analysis can provide insights into underlying conditions for an entity that may not be apparent from the raw figures.

The vertical analysis of the Statement of Profit or Loss for Carrier Enterprises is shown in Figure 8.1 and the vertical analysis of the Statement of Financial Position in Figure 8.2. Note how total revenue is taken as 100 per cent.

Carrier Enterprises			
Statement of Profit or Loss for month ended 31 December 2026			
	\$	\$	%
Sales	5000		
<i>Less sales returns</i>	<u>200</u>	4 800	81.4
<i>Less Cost of Goods Sold</i>		<u>2 300</u>	<u>39.0</u>
Gross profit		2 500	42.4
Add Other Revenue			
Commission Revenue		900	15.2
Rent Revenue		<u>2 500</u>	<u>42.4</u>
Total revenue		5 900	100.0
<i>Less Other Expenses</i>			
Advertising	1 600		
Delivery Vehicle Expenses	400		
Sales Salaries	1 300		
Insurance	200		
Office Salaries	<u>200</u>	<u>3 700</u>	62.7
Net profit		<u>\$2 200</u>	37.3

Figure 8.1 Vertical analysis of the Statement of Profit or Loss of Carrier Enterprises

Carrier Enterprises		
Statement of Financial Position as at 31 December 2026		
	\$	%
Assets		
Cash at Bank	460	0.3
Accounts Receivable	1 800	1.1
Inventories	18 750	11.5
Accrued Revenues	500	0.3
Prepaid Insurance	2 200	1.4
Vehicles	10 000	6.0
Building	80 000	48.9
Land	<u>50 000</u>	<u>30.5</u>
Total assets	<u>\$163 710</u>	<u>100.0</u>
Liabilities		
Accounts Payable	350	
GST Clearing (Payable)	85	
Accrued Expenses	500	
Unearned Revenues	<u>100</u>	
Total liabilities	1 035	0.6
Owner's Equity		
Capital (1 December 2026)	160 750	
Net profit	2 200	
Drawings	<u>(275)</u>	
Capital (31 December 2026)	<u>162 675</u>	<u>99.4</u>
	<u>\$163 710</u>	<u>100.0</u>

Figure 8.2 Vertical analysis of the Statement of Financial Position of Carrier Enterprises

From the vertical analysis of Carrier Enterprises, we can see a number of facts that, when combined with other information, may assist in informing management and external stakeholders of the financial position of Carrier Enterprises.

- Of the total revenue, only 42.4 per cent comes from the gross profit from the sale of goods. The same amount, 42.4 per cent, comes from rent revenue and 15.2 per cent comes from commission revenue. An assessment would need to be made as to the type of business Carrier Enterprises is, and whether this is an adequate and sustainable situation. If its main business is the purchase and sale of goods, then it may be more strategic to build up this side of the business. Therefore, this analysis can assist in deciding strategy for the future operations.
- Net profit comprises 37.3 per cent of the total revenue of the business. Again, consideration would need to be given to the type of business Carrier Enterprises is, and whether this is adequate and sustainable. Remember that some businesses – for example, supermarkets – historically operate on a low percentage of their profit from revenue (often called a low profit margin), whereas other businesses – for example, luxury car sales – might operate on a higher percentage. Again, judgement and consideration of circumstances need to be applied to this situation.
- Further, 99.4 per cent of the business funds comes from the owners, with debt being used to fund only 0.6 per cent of the assets. By all standards, this would be considered to be a very low percentage. If the business wishes to expand its trading operations, especially in line with the first point, then the raising of external debt may be considered.

- The owners must consider their investment in the business. They have invested \$162 675 in the business, but the business has only returned \$2200. By all measures, this is a very low return on money invested. Even if the owners liquidated the business and put their money into the bank, they would no doubt receive more than this with no risk. Running a business has risk attached, and so many would consider they needed a premium for a risky enterprise.

The comments above are not exhaustive, but merely an illustration of some of the insights that can be obtained by looking more deeply at the figures.

Ratio analysis

Another window into the story behind the financial reports is obtained by calculating various **financial ratios**. A ratio usually takes one item and expresses it as a percentage or ratio to another item in the financial statements. There are a number of ratios that are regularly calculated, and a survey of calculations used by analysts reveals that there are many variations in the calculation of the same ratio. The important point to realise is that consistency in the preparation of the reports, and in the calculation of the ratios from year to year or period to period, is necessary to allow for meaningful comparisons and consideration of trends.

Financial analysis requires the establishment of appropriate criteria or benchmarks against which ratios can be compared, so that meaningful interpretations can be made with the ratios calculated. These criteria may be based on past performance, past performance adjusted for changed circumstances, industry standards, predetermined or budgeted standards, or external factors such as current interest rates.

There are a number of categories of ratios that can be calculated, including measures of profitability or earning capacity, and measures of liquidity.

Measures of profitability or earning capacity

Profitability or **earning capacity** is usually the most important objective of the business. No business can continue to operate in the long term if it does not earn satisfactory profits. Without profits, it will not have the ability to employ people, to purchase new assets, to pay for expenses and accounts payable, or to allow owners to withdraw some profits for their personal use.

We will now expand on the ratios that are commonly used in decision making.

Net profit ratio

A net profit ratio can be calculated for either a service or trading business. Let us consider a service business first.

The net profit ratio is the ratio or percentage of net profit to net service revenue.

$$\frac{\text{Net profit}}{\text{Service revenue}} \times 100$$

This ratio shows how much of each dollar of service revenue represents net operating profit. It clearly indicates the margin of profitability of the firm. If the ratio is high, it indicates the opportunity to make high profits. Too low a figure gives less opportunity for profits and indicates the need for investigation of factors such as:

- expense control methods
- pricing practices
- selling techniques.

For example, if net profit is \$9743 and service revenue is \$15 870, the appropriate calculation would be:

$$\frac{9743}{15\ 870} \times 100$$

and the net profit ratio (or margin) would be 61.39 per cent.

This is quite a high margin of profit. However, the ratio itself is often not as important as trends or inter-business comparisons. Nor should it be forgotten that the end result depends on the actual amount

of services made and other revenue earned. No matter how high the ratio, if services are low, total earnings will be quite small. On the other hand, a low ratio with high service revenue can result in good profits. To improve this ratio a business would investigate increasing its marketing, increasing its service revenue through price changes or through advertising, or decreasing its costs in some way, perhaps by reducing staff.

Let us now move to trading businesses. The net profit ratio is calculated per dollar of net sales revenue. In the case of Carrier Enterprises (see page 325), net profit for the month of December 2026 was \$2200 and net sales \$4800. The appropriate calculation for Carrier Enterprises would therefore be:

$$\frac{\text{Net profit}}{\text{Net sales}} \times 100$$

$$\frac{2200}{4800} \times 100$$

and the net profit ratio (or margin) would be 45.83 per cent.

Gross profit ratio

This is an extra ratio calculated for trading businesses. The gross profit ratio is the ratio or percentage of gross profit to net sales.

$$\frac{\text{Gross profit}}{\text{Net sales}} \times 100$$

It indicates the margin of profit available to cover expenses.

Again using the figures in the example of Carrier Enterprises, gross profit is \$2500 and net sales is \$4800, so the appropriate calculation would be:

$$\frac{2500}{4800} \times 100$$

and the gross profit ratio (or margin) would be 52.08 per cent.

This is important because a high gross profit ratio allows the business to cover all expenses, earn a reasonable net profit and provide a satisfactory return to investors. A low ratio means that all expenses may not be covered, a net loss may be incurred, and a satisfactory return cannot be given to investors.

A gross profit ratio declining over a considerable period is cause for concern because the sale of goods is usually the main source of earnings for a business. Any opportunity should be taken to increase this ratio through:

- an increase in sales, with a less than proportional increase in the cost of goods sold (e.g. through a price increase or an advertising campaign)
- a decrease in the cost of good sold, with a less than proportional decrease in sales (e.g. through better buying or reducing theft or wastage).

The gross profit ratio for Carrier Enterprises indicates that just over 52 cents in every dollar of sales represents gross profit. This appears to be a very reasonable mark-up.

Both gross and net profit ratios may vary significantly between industries, so comparison is somewhat difficult. Consider the difference in margin that would be expected in a low-volume, high-profit business such as an antiques dealer, and a high-volume, low-profit business such as a large supermarket. However, comparisons with similar businesses, and trends revealed from year to year, will be most informative.

If it was found that similar businesses have a ratio of only 20 per cent, and that last year our ratio was 40 per cent, then we would be pleased. If, however, it was found that industry averages were constantly around 80 per cent while last year our margin was 60 per cent, this would not be considered a good result. Steps would have to be taken to improve this situation.

Return on owner's equity

The rate of return on owner's equity is the ratio or percentage of net profit to average owner's equity over the period.

$$\frac{\text{Net profit}}{\text{Average owner's equity}} \times 100$$

This ratio indicates the rate of return on owner's equity invested in the business.

Business owners take risks. Return on owner's equity should be considered relative to current interest rates and the degree of risk, in order to evaluate profitability.

Let us assume that net profit is \$9743, owner's equity at the beginning of the period is \$80 000 and owner's equity at the end of the period is \$85 543. Therefore, average owner's equity would be \$82 772, so the appropriate calculation would be:

$$\frac{9743}{82\,772} \times 100$$

and the rate of return would be 11.77 per cent.

When examined in terms of trends, inter-business comparisons and alternative investment opportunities, a judgement can be made as to how effectively invested funds are being employed, and whether investors should consider some of the alternative investment opportunities open to them.

It is evident that the return of 11.77 per cent is quite high. Even money placed with most financial institutions (risk-free returns) would earn interest less than this rate of return.

The return on owner's equity for Carrier Enterprises for the month of December 2026 was:

$$\frac{\text{Net profit}}{\text{Average owner's equity}} \times 100$$

$$\frac{2200}{(160\,750 + 162\,675)/2} \times 100$$

$$\frac{2200}{161\,712.50} \times 100$$

and the return on owner's equity would be 1.36 per cent. Again, this return needs to be compared to risk-free returns in any evaluation.

Check for understanding

- 8.1 a **Analyse** the following information for Benton Industries and **calculate** the net profit ratio and return on owner's equity for each year.
- b **Create** a short report to the owner, J Benton, commenting on the results and making some general recommendations.

	This year	Last year
Service revenue	\$28 000	\$31 000
Net profit	\$7 000	\$7 000
Owner's equity (at year end)	\$80 000	\$85 000

Averages for the industry in which Benton Industries operates show net profit ratios of 30 per cent and returns on owner's equity of 12 per cent. Owner's equity at the beginning of last year was \$85 000.

- 8.2 a **Analyse** the following information for Potaka Enterprises and **calculate** the net profit ratio and return on owner's equity for each year.
- b **Create** a short report to the owner, R Potaka, commenting on results and making recommendations for improvement.

Averages for the industry in which Potaka Enterprises operates show net profit ratios of 22 per cent and returns on owner's equity of 18 per cent.

Potaka Enterprises		
Statement of Profit or Loss for year ended 30 June		
	This year	Last year
	\$	\$
Revenue		
Service Revenue	145 000	150 000
Commission Revenue	<u>1 000</u>	<u>1 000</u>
	<u>146 000</u>	<u>151 000</u>
Less Other Expenses		
Advertising	1 000	3 000
Other Expenses	90 000	88 000
Supplies Expense	14 000	8 000
Wages and Salaries	<u>20 000</u>	<u>14 000</u>
Net profit	<u>\$21 000</u>	<u>\$38 000</u>

Potaka Enterprises		
Statement of Financial Position as at 30 June		
	This year	Last year
	\$	\$
Assets		
Cash at Bank	1 000	500
Accounts Receivable	1 500	1 300
Equipment	17 900	15 400
Vehicles	12 000	15 000
Building	70 000	75 000
Land	<u>75 000</u>	<u>75 000</u>
	177 400	182 200
Less Liabilities		
Accounts Payable	<u>4 800</u>	<u>4 200</u>
Net assets	<u>\$172 600</u>	<u>\$178 000</u>
Owner's Equity		
Capital	178 000	170 000
Add Net profit	<u>21 000</u>	<u>38 000</u>
	199 000	208 000
Less Drawings	<u>26 400</u>	<u>30 000</u>
	<u>\$172 600</u>	<u>\$178 000</u>

Measures of liquidity

While measures of profitability are important, so too are measures of liquidity. It is vital that a business can meet its ongoing obligations, and two of the key measures of this are the rate of turnover of inventories and the rate of turnover of accounts receivable.

Rate of turnover of inventories

The rate of turnover of inventories is the ratio of cost of goods sold to average inventories for the period. It measures the number of times during the period that average inventories are sold. It may also be expressed as the number of days it takes to sell the average inventory. The average inventory is found by dividing inventory figures by the appropriate period – for example, the sum of a year’s daily figures by 365, the sum of monthly figures by 12, the sum of beginning and end of year figures by two, or the sum of beginning and end of month figures by two.

The relevant calculation is:

$$\frac{\text{Cost of goods sold}}{\text{Average inventories}}$$

If we find that cost of goods sold for a year was \$580 000, and that opening inventories are \$100 000 and closing inventories are \$90 000, average inventories would be \$95 000, and the turnover would be 6.11 times per year, or 59.74 days. To convert the number of times per year to days, it must be divided **into** 365.

If such figures are not available, end of period figures may have to do. (The period could, of course, be a month rather than a year.) Where figures are available, the turnover can also be calculated on individual types of inventory or groups of inventory items that may require different rates of turnover due to features such as fashion or perishability. This ratio is an indicator of the overall level of business activity and of inventory levels required to run the business efficiently.

If the rate of stock turnover is low, it indicates a low level of sales and/or a high level of inventories. Just how much cause for concern this is depends on factors such as the type of goods sold, profit margins achieved and general economic conditions. For example, an antiques store has a lower rate of turnover than a chain store, but would work on a higher profit margin. A greengrocer would have a high turnover because the goods are perishable.

Turnover can be improved by reducing prices, holding special sales at reduced prices, or by increasing advertising and marketing. The ratio will also improve if the amount of stock carried can be reduced.

The turnover of inventories for Carrier Enterprises (see page 325) for the month of December 2026 was:

$$\frac{\text{Cost of goods sold}}{\text{Average inventories}}$$

$$\frac{2300}{(20\,000 + 18\,750)/2}$$

$$\frac{2300}{19\,375}$$

and the rate of turnover of inventories was 0.12 times. This is very low, but it is a new business.

Rate of turnover of accounts receivable or book debts

The rate of turnover of accounts receivable is the ratio of net credit sales to average accounts receivable (book debts).

$$\frac{\text{Net credit sales}}{\text{Average accounts receivable}}$$

This ratio measures the number of times each period the accounts receivable are turned over, or how many days it takes to collect average book debts. It is found by dividing total credit sales by the average accounts receivable for the period. Again, either average figures would have to be worked out from information available, or the end of period figures would have to be accepted as representative of the period. This ratio would commonly be calculated on either a yearly or monthly basis.

The ratio indicates how quickly accounts receivable pay their debts, and helps the business judge the effectiveness of credit control and collection policies. If the turnover period proves to be longer than the normal credit period allowed under the business's credit policy (usually 7 or 30 days), management would need to investigate the reasons why this has occurred.

If net credit sales for a year were \$220 000, accounts receivable at the beginning of the year \$40 000, and accounts receivable at the end of the year \$36 000, average accounts receivable would be \$38 000, and the turnover would be 5.79 times per year, or 63.04 days. If our normal credit period was 60 days, this would be reasonable. If it was 30 days, this would be very poor, and indicate the need for careful attention to credit collection and swift action to recover outstanding debts.

To improve the turnover of accounts receivable, credit policies and terms may have to be tightened, discounts for prompt payment could be offered, and slow payers telephoned and sent appropriate letters and demand notices, or passed to collection agencies.

The turnover of accounts receivable for Carrier Enterprises for the month of December 2026 is not very relevant. The business has only just commenced and accounts receivable could well pay within the normal 30-day credit terms. Therefore, there is not much use in calculating and analysing the turnover of accounts receivable in this instance.

We can now summarise the ratios examined to date.

Ratio	Formula	Measures	Benchmark
Measures of profitability or earning capability			
Net profit ratio	$\frac{\text{Net profit}}{\text{Net service revenue or net sales}} \times 100$	Net profit per dollar of service/net sales	Industry average
Gross profit ratio	$\frac{\text{Gross profit}}{\text{Net sales}} \times 100$	Gross profit per dollar of net sales	Industry average
Return on owner's equity	$\frac{\text{Net profit}}{\text{Average owner's equity}} \times 100$	Return on investment provided by owners	Current interest rates
Measures of liquidity			
Turnover of inventories*	$\frac{\text{Cost of goods sold}}{\text{Average inventories}}$	How quickly inventory is sold, and thus indicates liquidity of inventories	Industry average
Turnover of accounts receivable*	$\frac{\text{Net credit sales}}{\text{Average accounts receivable}}$	Effectiveness of collections and whether accounts receivable are too high	Industry average
*If turnover is required in days, the turnover rate as calculated above must be divided into 365 or the number of days in the period that is relevant.			

Real-world application



It's not how much money you make, but how much money you keep, how hard it works for you, and how many generations you keep it for.

Source: Robert Kiyosaki, Rich Dad, Poor Dad. Item 47 from 'Top 100 Money Quotes of All Time', Rob Berger, Forbes, 30 April 2014, <https://www.forbes.com/sites/robertberger/2014/04/30/top-100-money-quotes-of-all-time/#845be204998d>

REPORT TO MR J BARTRIM

31 January 2027

Re Analysis and Interpretation of Financial Statements of Carrier Enterprises for the month ended 31 December 2026

I have examined the financial statements of Carrier Enterprises. Considering this business has just begun, this report deals with an analysis of the financial statements concentrating on the profitability and liquidity of the organisation as measured by various financial ratios.

PROFITABILITY

As evidenced in the Statement of Profit or Loss, the business has a gross profit margin of 52.08% and a net profit for the month of \$2200. Your net profit margin of 45.83% is very high when compared to the average benchmark of 15% for other organisations operating in this market. However, it should be noted that the business had Other Revenues of commission and rent totalling \$3400, so these helped to cover the costs of the Other Expenses incurred during December of \$3700. It is therefore very important that the gross profit margin be maintained.

In addition, the return on owner's equity of 1.36% is just under the current interest rate return of 1.5% prevailing in the market place. This is acceptable at this beginning stage of the development of the business.

FINANCIAL POSITION AND LIQUIDITY

The financial position of the business is sound, given that you have assets of \$163 710 with very few liabilities. The turnover of inventories is a very low: 0.12 times.

CONCLUSIONS

Your business has done well in its first month of operation. Hopefully, you will build your sales as this is the key to your success.

RECOMMENDATIONS

Your Other Revenue was a key contributor to the high net profit. While this is very acceptable in a beginning business, every endeavour must be made to increase sales and improve the turnover of inventories. Perhaps more should be spent on advertising to make your business known to potential customers. Another alternative is to employ more sales staff to improve sales.

As in any beginning business, a careful watch must be kept on all expenses to ensure they are contributing to the generation of profit.

Karl Branson CPA

Real-world application



Key CFO Skills for 2024

By Yvonne Chan FCPA

CFO and vice president, Singapore Management University

'CFO'¹ tends to be associated with creating charts and graphs, and working with hard numbers – skills that are normally linked to systematic left-brain processing, which may come across as unfeeling and inflexible.

However, more so now than in the past, the demand is transitioning to skills that use more right-brain processing, such as creativity and human-related skills. The orientation is more on people than on tasks.

Let me name three of the human-related skills – people management, storytelling and business partnership.

First, with more hybrid work, the office has morphed into a place for interactive collaboration such as discussion, brainstorming, training and meetings. CFOs are required to understand individual and team motivations in order to achieve organisational goals and outcomes.

Second, there is a shift to developing a compelling narrative around numbers and graphics. What is the story behind what is being presented? Is it contextualised to the stakeholder that we are speaking with and in a format they understand?

Third is business partnership, to comprehend the industry and unit that we are supporting.

Resources will continue to be limited for competing needs. Hence, it is imperative for the finance partner to be more customer-centric, understand the constraints and help businesses to scale their mountains and jog alongside them, especially during the most difficult times.

Extract from *Key CFO Skills for 2024*, In the black magazine, p.11. Source: <https://intheblack-magazine.cpaaustralia.com.au/cpa-australia/intheblack-december-2023-january-2024-special-edition?pid=0Dc8766968&p=11&v=4.2>

Check for understanding

- 8.3 **Analyse** the information on the following page, which has been extracted from the books of Watson Plumbing Supplies.
- a **Calculate** for each year the:
 - i gross profit ratio
 - ii net profit ratio
 - iii rate of turnover of inventories
 - iv rate of turnover of accounts receivable
 - v rate of return on owner's equity.
 - b **Identify** what general areas are being tested by each of these measures.
 - c **Create** a report (see pages 304 and 333) for G Watson to comment in an interpretative manner on what is revealed by these measures. Include any relevant graphs (see page 213). The current interest rate is 6.5 per cent.

¹ 'CFO' stands for Chief Financial Officer.

	30 June 2026	30 June 2025
	\$	\$
Assets		
Cash at Bank	20 000	55 000
Inventories	90 000	80 000
Accounts Receivable	40 000	45 000
Plant and Equipment	280 000	250 000
Motor Vehicles	120 000	110 000
Shares	<u>50 000</u>	<u>50 000</u>
	<u>\$600 000</u>	<u>\$590 000</u>
Liabilities and Owner's Equity		
Accounts Payable	72 000	63 000
Capital	<u>528 000</u>	<u>527 000</u>
	<u>\$600 000</u>	<u>\$590 000</u>
<i>Additional information</i>		
• Sales (cash) 30 June 2026, \$40 000; 30 June 2025, \$35 000.		
• Sales (credit) 30 June 2026, \$400 000; 30 June 2025, \$300 000.		
• Cost of goods sold 30 June 2026, \$220 000; 30 June 2025, \$150 000.		
• Net profit 30 June 2026, \$25 000; 30 June 2025, \$20 000.		
• Inventories at 1 July 2024 were \$70 000.		
• Capital at 1 July 2024 was \$426 000.		
• Accounts receivable at 1 July 2024 were \$49 000.		
• Drawings have been kept to a minimum over the two-year period.		

8.4 Analyse the following comparative Statements of Profit or Loss and Financial Position for Pritchard Industries.

- a Calculate** appropriate ratios.
- b Create** a written report with appropriate graphs (see pages 304 and 333) to management on the results:

Pritchard Industries				
Comparative Statements of Profit or Loss for years ended				
	30 June 2026		30 June 2025	
	\$	\$	\$	\$
Sales				
Cash	60 000		50 000	
Credit	<u>300 000</u>	360 000	<u>210 000</u>	260 000
Less Cost of Goods Sold		<u>215 000</u>		<u>155 000</u>
Gross profit		145 000		105 000
Less Other Expenses				
Advertising	7 000		5 000	
Delivery Expenses	19 000		14 000	
Sales Salaries	12 000		10 000	
Insurance	9 000		8 000	
Office Salaries	16 000		14 000	
Office Expenses	33 000		24 000	
Interest on Mortgage	<u>10 000</u>	<u>106 000</u>	<u>7 000</u>	<u>82 000</u>
Net profit		<u>\$39 000</u>		<u>\$23 000</u>

Pritchard Industries				
Comparative Statements of Financial Position as at				
	30 June 2026		30 June 2025	
	\$	\$	\$	\$
Assets				
Accounts Receivable	65 000		55 000	
Inventories	100 000		80 000	
Prepaid Expenses	10 000		5 000	
Delivery Vehicles	60 000		50 000	
Land	100 000		50 000	
Buildings	<u>100 000</u>		<u>50 000</u>	
Total assets		<u>\$435 000</u>		<u>\$290 000</u>
Liabilities				
Bank Overdraft	36 000		20 000	
Accounts Payable	100 000		80 000	
GST Payable	6 000		5 000	
Accrued Expenses	14 000		15 000	
Mortgage	<u>80 000</u>		<u>40 000</u>	
Total liabilities		<u>236 000</u>		<u>160 000</u>
Net assets		<u>\$199 000</u>		<u>\$130 000</u>
Owner's Equity				
Capital		<u>199 000</u>		<u>130 000</u>
Total owner's equity		<u>\$199 000</u>		<u>\$130 000</u>
<i>Additional information</i>				
From the previous records of Pritchard Industries it was found that:				
<ul style="list-style-type: none"> • Capital at 1 July 2024 was \$100 000. • An additional \$30 000 was introduced as capital during the period 1 July 2025 to 30 June 2026. • Accounts receivable were \$50 000 and inventories were \$70 000 at 1 July 2024. 				

- 8.5** Jazz It is the clothes label of dynamic and talented Melissa Young. You are very good friends with Melissa and often help her out on her Sunday market stall. Melissa's clothes are originals, which she makes from home. She has been selling her clothes at pop-up stalls and markets on average about four days a week. On the other days, she works at a coffee shop, taking as many shifts as she can fit in around her clothes selling and production. Melissa is very keen to continue to expand and is considering opening a retail outlet in an up and coming area. She says that the figures she has given you are from her clothing activities. She is not sure what the concept of owner's equity means, but says that her figures include all her personal assets (e.g. her car) and liabilities.

Based on the information Melissa has given for the year ended 30 June 2026, advise her on the best course of action.

Total Sales (net)	\$50 000
Cost of Sales	\$20 000
Gross Profit	\$30 000
Net Profit	\$25 000
Inventories 1.7.2025	Melissa could not provide you with this figure
Inventories 30.6.2026	\$5000
Accounts Receivable 1.7.2025	Melissa could not provide you with this figure
Accounts Receivable 30.6.2026	\$400
Owner's Equity 1.7.2025	Melissa could not provide you with this figure
Owner's Equity 30.6.2026	Melissa had difficulty providing you with this figure, but said it mainly comprised cash in her bank (\$2000), the value of her car (\$11 000) and credit card debt (\$10 000).

Ten per cent of sales are made on credit, and Melissa only offers credit to very special customers. Most of her sales are for cash.

- a **Identify** which items could make up the Inventories at 30 June 2026.
 - b **Identify** which items could make up the Owner's Equity at 30 June 2026. **Explain** whether you are certain or uncertain about including each item, and why.
 - c **Calculate** the gross profit ratio, the net profit ratio, the return on owner's equity, turnover of inventories and turnover of accounts receivable.
 - d Using the data you have calculated, **analyse** the effectiveness of Melissa's business for the year. You may need to make a number of assumptions, and if so, state these assumptions. Provide some recommendations moving forward for Melissa.
- 8.6 Technology is affecting the business practices of both trading and service businesses. Examine the 2023 annual report of Qantas (primarily a service business) and Woolworths (primarily a trading business).
- a **Identify** the various aspects of their business.
 - b **Create** a paragraph to **explain** how business practice is being changed by technology.
 - c Discuss with your classmates the possible implications of these changes on the business's revenue and expenses.



Weblinks
Qantas Airways
annual reports

Woolworths
Limited annual
reports

CHAPTER REVISION

8.7 Multiple choice

Complete the following multiple-choice questions by choosing the best answer.

- 1 If service revenue for the year was \$275 000 and all other expenses totalled \$180 000, the net profit ratio would be:
 - A 65.46 per cent
 - B 52.77 per cent
 - C 34.55 per cent
 - D none of the above.
- 2 The net profit ratio would be:
 - A 2 per cent
 - B 19 per cent
 - C 20 per cent
 - D 1.9 per cent.
- 3 The gross profit ratio would be:
 - A 57.9 per cent
 - B 55 per cent
 - C 50 per cent
 - D 37.9 per cent.
- 4 The rate of turnover of inventories in days would be:
 - A 18.25 days
 - B 36.5 days
 - C 27.38 days
 - D none of the above.
- 5 The rate of turnover of book debts in days would be:
 - A 40.15 days
 - B 38.42 days
 - C 43.82 days
 - D 42.25 days.

You are given the following information for a year.

Use it to answer Questions 2–5:

Sales (all credit) \$500 000; Sales returns \$25 000;
 Cost of goods sold \$200 000; all other expenses totalled \$180 000; inventories at the beginning of the year \$10 000; inventories at the end of the year \$20 000; accounts receivable at the beginning of the year \$50 000; accounts receivable at the end of the year \$60 000.

8.8 Case study

Synthesise the information in Stimuli 1–6. **Prepare** a Profit or Loss Statement for the 6 months ended 30 June 2026, a Statement of Financial Position as at 30 June 2026, and a report **analysing** and **evaluating** the proposed purchase of the gym.

STIMULUS 1

Your best friend, Alison Manson, has just inherited \$50 000 from her aunt's estate. She will finish her Bachelor of Physical Sports in 2 months, at the same time as you graduate. She wishes to use her inheritance to purchase a gym and has asked your advice. There is a small gym for sale very close to where she lives, called Gym Lovers. The asking price is \$50 000. Her parents think it is a bad investment, but you wish to analyse it fully and help her convince her parents that it is a 'good buy'.

STIMULUS 2

Gym Lovers		
Statement of Profit or Loss for six months ended 30 June 2026		
	\$	\$
Revenue		
Yearly Membership Fees	150 000	
Casual Class Fees	<u>500</u>	150 500
Less Expenses		
Purchases of Gym Equipment	120 000	
Wages and Salaries	25 000	
Rent of Premises	5 000	
Electricity	<u>3 000</u>	<u>153 000</u>
Loss		<u><u>(\$2 500)</u></u>

STIMULUS 3

You have a chat with Alison and ascertain that she doesn't think she will need to buy any new assets in the foreseeable future. She tells you the gym equipment was purchased brand new on 1 January 2026 by the existing owners and she estimates the life of the equipment to be 10 years.

STIMULUS 4

You talk to the current owners of Gym Lovers. They tell you they commenced operating the gym on 1 January 2026 and purchased the new gym equipment from funds they have received from memberships. This has been the only investment they have made in the business to date. They are using cash accounting for their accounting records.

STIMULUS 5

You visit the gym and talk to the front counter staff about memberships. They do not have details of individual memberships, but supply you with some bank statement information.

Bank Statement (extracts) Gym Lovers				
Deposit No	Transaction ID	Date	Amount	Description
10	DIR 400	1/1/2026	\$50 000	Yearly memberships of \$500 each
12	DIR 402	1/1/2026	\$90 000	Two yearly memberships of \$900 each
14	DIR 404	30/6/2026	\$10 000	Three yearly memberships of \$1000 each
16	DIR 420	30/6/2026	\$ 500	Casual class fees

STIMULUS 6

The casual class fees are a new concept and have only been collected for the past month. Alison believes there appears to be ample room for this to continue, but that she will need to spend money on advertising to increase these receipts.

8.9 Case study

Synthesise the information in Stimuli 1–3.

STIMULUS 1 – 30 JUNE

Account	\$
Telephone	400
Sales	110 000
Capital (1 July)	118 000
Interest Revenue	1 000
Commission Revenue	2 000
Drawings	40 000
GST Collected	10 000
GST Credits Received	5 000
Cash at Bank (overdraft)	4 000
Loan to Brown Brothers	13 000
Accounts Payable	16 800
Cost of Goods Sold	58 000
Inventories	5 000
Sales Returns	450
Accounts Receivable	1 000
Wages and Salaries	23 950
Office Expenses	3 000
Prepaid Insurance	2 000
Buildings	50 000
Land	60 000

STIMULUS 2

Chan Furnishings
Office Memorandum

Date: 30 June

From: S Chan

The following are balance day adjustments at 30 June:

- Insurance consumed is \$1500.
- Unearned commission revenue is \$1000.
- Accrued wages expenses are \$1000.
- Accrued interest revenue is \$600.

STIMULUS 3

Chan Furnishings, owned by S Chan, sells high-quality furniture. After discussions with the owner, you understand that she is concerned about whether it is worthwhile continuing to operate the business.

Using Stimuli 1–3:

- a **prepare** a Statement of Profit or Loss for the year ended 30 June in a spreadsheet
- b **prepare** a Statement of Financial Position as at 30 June in a spreadsheet
- c **create** a report advising on the profitability of the business, and specific recommendations.

INDEX

- Aboriginal and Torres Strait Islander groups 15
- absolute reference (spreadsheets) 207
- account 49
 - analysis of 57
 - asset 50
 - format 49–50
 - need for 49
 - type of 96
- accountability 11
 - discharging 11
- accountants 16, 19, 183
- accounting/accounting process 79–80
 - accountants and 19
 - basic assumption of 50
 - by business firms 8
 - for business organisations 3–8
 - to closing entries 260–3
 - communication 9
 - complete 267
 - concepts of 38
 - for control accounts and subsidiary ledgers *see* control accounts and subsidiary ledgers
 - definition of 8–9
 - factors impacting 19–22
 - function of 11
 - for goods and services tax (GST) 115–19
 - journal *see* journal
 - modules/elements 160
 - objectives 10
 - for sole trader and company 40
 - transactions with GST 120–47
- accounting controls 163, 294
- accounting entity assumption 14
- accounting entity concept 28, 79
- accounting equation 28–30
 - detailed examination of 31
 - and Statement of Financial Position 32–7
- accounting information, for decision making 9
- accounting packages 158–64
 - computer 163
 - control accounts and subsidiary ledgers 169
 - features of 159–60
 - inventories 181–93
 - spreadsheets and 284–9
- accounting period 225–7
- accounting profession 20
 - in Australia 16–19
- accounting records 79
 - using perpetual inventory system 187–91
- accounting reports 10
- accounting services, demand for diversity of 21
- accounting software 158 *see also* accounting packages; spreadsheets
- Accounting Standard AASB 102, 181
- accounting standards 17
- accounting systems 159
 - conceptual and computer 162
 - real-world 161–3
- accounting technology 157
 - accounting packages *see* accounting packages
 - accounting software 158
 - computer system 154–7
 - MYOB AccountRight 164–8
 - spreadsheets 204–17
- account rules 50–2
- Accounts command centre 166, 202
- Accounts List 166
- Accounts Payable account 127, 136
- Accounts Payable Control account 169, 173
- accounts payable/creditors 27
- Accounts Payable ledger 169
- Accounts Payable Listing 173
- accounts receivable 7, 86, 301, 303
 - rate of turnover of 332
- Accounts Receivable Control account 169
- Accounts Receivable ledger 169
- Accounts Receivable Listing 178
- accrual basis of accounting 41
- accruals 246–9
- accrued expenses
 - balance day adjustments 246–8
 - reversing entries 264–5
- Accrued Expenses account 248
- accrued revenues
 - balance day adjustments 248–9
 - reversing entries 265–6
- Accrued Revenues account 249
- accuracy 208
- accurate 156
- acquisitions/inputs 113
- Acrobat PDFs 156
- adjusted trial balance, preparation of 254–6
- Adjust Inventory 201
- adjustment/credit notes 91, 117–18, 301, 314
- administrative controls 163, 294
- advisory service 53
- ‘ageing the accounts receivable’ 303
- analysing transactions
 - journal 93–102
 - ledger account 53–5
- application software 156
- Arthur Andersen 21
- Artiste Perfection 103–6
- asset account 50, 130
- assets 7, 26
 - current 136
 - and liabilities 6, 124
 - purchase of 136
- auditor 17
 - role 17
 - types of 17
- audit report 17
- audit trails 159
- Australia, accounting profession in 16–19
- Australian Accounting Standards Board (AASB) 17, 110
- Australian Bureau of Statistics 10
- Australian Business Number (ABN) 114
- Australian Charities and Not-for-profits Commission (ACNC) 15
- Australian Charities and Not-for-profits Commission Act 2012* 15
- Australian Securities and Investment Commission (ASIC) 14

- Australian Taxation Office (ATO) 10, 111, 117, 127
- Australia Post 130
- authorisation 295
- automatic 156
- automatic postings 161

- back order 314
- balance day adjustments 59, 245, 251, 266, 272
 - accruals 246–9
 - prepayments 249–53
 - record and post 246
- Balance Sheet 32
- Banking command centre 197–8
- bank payment 87
- bank reconciliation 89
- Bank Reconciliation Statement 234
- Bank–State–Branch (BSB) number 86
- bank statement 85–6, 88
- barcodes 184
 - inventory control using 317
- beneficiaries 15
- better system 308
- billing 301
- Bitcoin 110
- Blacklock Traders 302, 303, 305
- Blockchain 110
- book debts 332
- bottom line 6
- budgeted 11
- Business Activity Statement (BAS) 115, 269
- business advisory service 94
- business conduct 20–1
- business enterprise 14
- business environment 19
- businesses 4
 - registration for GST 113–14
- business ethics 21, 157
- business firms 8
- business graphics, in spreadsheets 213–17
- business organisations
 - accounting for 3–8
 - forms of 13–15
- business ownership 13
- business transactions 82, 92
- BusServe 94
- buy and sell inventories 181
- buyer/purchaser 90

- Capital account 124, 260
- capital contributions or loans 41
- card receipts 84
- Carrier Enterprises 269–70
- cash 41–4
 - drawings of 137
 - recording 84
- Cash at Bank account 66–7, 69, 71, 86, 94, 96, 107–8, 121, 122, 127, 128, 131, 137, 234
- cash balances 9
- cash flows
 - defined 42
 - from financing activities 4, 42
 - inflows or outflows 42
 - from investing activities 4, 42
 - nature of 41–4
 - from operating activities 4, 42

- Cash Payments journal 93
- Cash Purchases 198
- cash reconciliation 84
- cash register 84
 - reconciliation 84, 85
- cash register docket 84
- cash register summary 84, 85, 314
- Cash Sales subsidiary ledger account 200
- Certified Practising Accountant (CPA) 19, 21
- changes in financial position 41
- Chartered Accountant (CA) 19
- Chartered Accountants Australia and New Zealand (CA ANZ) 16
 - code of ethics 21
- chart of accounts 63, 119, 166, 191, 349
- Chart Ribbon 213
- Chemist Warehouse payment screen 81
- cheque 87
- cheque butt 88
- closing entries 260–3
- closing inventories 311
- cloud computing 155
- code of ethics 21
- columnar format ledger account 50
- columnar ledger accounts
 - advantages 70
 - balancing 69
 - preparation of 68–70
- column/bar charts 213–14
- Commission Revenue account 248, 265
- Commonwealth Act 15
- communication 12
 - software 158
- compact business records 156
- companies 14–15, 20
- company information screen 165
- computer accounting packages 163
- computer generated (most common) 80
- computerised accounting systems 93
- computer packages 20
- computer systems 90, 154–7
 - benefits 156
 - hardware 154–5
 - people 156
 - software 155–6
- conceptual and computer accounting systems 162
- consumable supplies 120–1
- control 163
- control accounts and subsidiary ledgers 169, 301, 305
 - for accounts receivable and accounts payable 170–8
 - advantages 178–81
 - in general ledger 187
- control over credit 297–310
- control over inventories 311–19
- corporate credit cards 306
- corporate governance 10
- Corporations (Aboriginal and Torres Strait Islander) Act 2006* (CATSI Act) 15
- Corporations Act 15, 20*
- Corporations Act 2001* 14
- correction of errors 139
- costing method 183
- cost of goods sold 38, 184

- Cost of Goods Sold account 126, 130, 131, 191
 - in general ledger 187
 - Inventories and 190–1
- cost\purchase price 80
- cost price 126
- costs 126
- Count Inventory 201
- credit 319–21
 - control over 297
 - importance of 297
- credit approval 301
- credit balance 69
- credit cards 299–300
- credit note 301, 314
- Creditors Control account 169
- credit policy 301
- credit purchases of items (no GST) 89–90
- credit sales of goods and services (no GST) 89–90
- credit score 308–309
- credit transaction 298
- creditworthiness 301
- Cronder Wholesalers 127–8
- crypto assets 110
- current assets 136
- cycle billing 303

- Dark Ages 54
- debit balance 69
- debit cards 299–300
- Debtors Control account 169
- debts 41
- decision making
 - accounting information for 9
 - financial information for 11
- decreasing adjustment 117
- delivery docket 313
- despatch docket 313, 314
- development software 155
- digital currencies 110
- digital documents 159
- direct transfer 82
- discharging accountability 11
- discipline 9
- disclosing cash flows 41
- diversity, of accounting services 21
- dividends 7, 14, 41
- documents 296
- double entry 54, 71, 79
- double-entry bookkeeping 19
 - development and power of 54–5
- double-entry principle 170
- downloading data 159
- drawer 87
- drawings 100
 - of cash 137
 - of inventories 138
- Drawings account 137, 138

- earning capacity 327–9
- Easy Setup Assistant 195
- economic factors 20
- electronic business 20
- electronic data interchange (EDI) 82, 314
- electronic funds transfer (EFT) 86
- electronic spreadsheets 204

- end of period reporting
 - accounting period and profit determination 225–7
 - adjusted trial balance 254–6
 - balance day adjustments 245–53
 - closing entries 260–3
 - financial statements, preparation of 257–9
 - preparation of 267–84
 - reversing entries 264–7
 - Statement of Cash Flows *see* Statement of Cash Flows
 - Statement of Financial Position *see* Statement of Financial Position
 - Statement of Profit or Loss *see* Statement of Profit or Loss
- Enron 21
- enterprise resource planning (ERP) systems 158
- Enter Purchases 198, 199
- Equipment Suppliers 136
- errors 178
 - correction of 139
 - by trial balance 71, 72
- Ethereum 110
- ethical conduct 20–1
- evaluating performance 11
- expansion 41
- expenses 38–9
 - accrued 246–8, 264–5
 - Cost of Goods Sold 191
 - ledger accounts 58–9
 - paying 122–5
 - prepaid 249–52, 266
- export-oriented industry 20
- external audit 17
- external auditor 17
- external finance 41
- external party 42
- external sources 41
- external users 10

- Fernall Pty Ltd 86
- financial accounting 20
- financial analysis 327
- financial information 3
 - for decision making 11
- financial ratios 327
- financial statements 3, 19 *see also* Statement of Cash Flows; Statement of Financial Position; Statement of Profit and Loss
 - illustrative example 5–6
 - interrelationships between the statements 7
 - preparation of 257–9
- financing activities (cash flows) 4, 42
- financing flows 7
- first-in first-out (FIFO) method 183
- flexibility 156
- flexible chart of accounts 159
- formal accounting reports 10
- formatting 207
- furniture account 49, 137, 139
- Furniture Traders Ltd 137

- general journal 93, 97–101, 122–3, 138, 193, 253
 - accounting entry in 128
 - transactions in 122
 - two-column 93

- general ledger 169, 190
 - control account in 187
 - Cost of Goods Sold account in 187
 - inventory adjustment account in 187–91
- general purpose reports 10, 11
- going concern principle 80
- goods and services tax (GST) 34, 111–19
 - accounting and reporting for 115–19
 - affects supply chain 112
 - clearing entries 268–9
 - consumable supplies 120–1
 - correction of errors 139
 - different types of transactions with 120–47
 - drawings of cash 137
 - drawings of inventories 138
 - illustrative example 132–4, 140–5
 - ledger and chart of accounts 119
 - paying expenses 122–5
 - purchase of assets 136
 - purchases of inventories 126–7
 - purchases returns and allowances 127–8
 - registered business entities 113–15
 - sale of assets 136–7
 - sales of inventories 129–30
 - sales returns and allowances 130–1
 - selling services 121
 - using perpetual inventories 134
- governance, organisation 10
- governments 8
- Granton Ltd. 120
- Green Advice 53, 54, 70
- gross profit ratio 328
- GST Clearing account 268–9
- GST Collected account 129, 131, 137, 268
- GST Credits Received account 122, 127, 136, 138
- GST-exclusive amount 111
- GST-free supplies 112–13, 140, 145
 - and perpetual inventory system 188
- hardware 154–5
- historical cost principle 80
- historical development 19–20
- 'hole in the ledger account' 251
- identification (ID) number 82
- Income Statement 39
- increasing adjustment 117
- individual asset accounts 249
- individual liability accounts 248
- Industrial Revolution 20
- input tax credits 112–13, 138
- Input taxed supplies 112
- internal accounting controls 295–7
 - authorisation 295
 - documents and records 296
 - physical controls and security 296
 - reliable, competent personnel 295
 - responsibility 295
 - rotation of duties 295–6
 - separation of duties 295–6
 - verification 295
- internal auditor 17
- internal controls
 - control over credit 297–310
 - control over inventories 311–19
 - corporate credit cards 306
 - credit, inventories, profitability and liquidity 319–21
 - nature and importance 294–7
 - over accounts payable 305–6
 - over purchase of inventories 313
 - types of 294
 - internal memorandum 91
 - internal sources 41
 - internal transactions 91
 - internal users 10
 - International Financial Reporting Standards (IFRS) 17
 - interpersonal skills 12
 - inventories 38, 319–21
 - accounting packages 181–93
 - control over 311–19
 - drawings of 138
 - importance of 311
 - inventory costing methods 182–7
 - perpetual inventory system 182
 - purchase of 313
 - purchase of assets other than 136
 - purchases of 126–7
 - rate of turnover of 331
 - sale of 314–15
 - sale of assets other than 136–7
 - sales of 129–30
 - turnover of 316
 - Inventories account 126, 127
 - Inventories command centre 201
 - Inventories Control account 187, 190, 191
 - inventory adjustment account, in general ledger 187–91
 - inventory control, using barcodes 317
 - inventory costing methods 182–7
 - First-In First-Out (FIFO) method 183
 - specific identification method 183
 - stock item record 184–5
 - weighted average cost method 184–6
 - Inventory Stocktake Sheet 312
 - inventory subsidiary ledger 187–91
 - investing activities (cash flows) 4, 42
 - investing flows 7
 - investment expenditure programs 41
 - investments 3
 - investors, financial information to 3
 - invoice 89, 90
 - invoice copy 90
 - inward movements of goods 126
 - item product screen 197
 - J J Electrical Wholesalers 132
 - journal 92–111
 - analysing transactions 93–102
 - functions of 92
 - general 93
 - illustrative example (no GST) 103–8
 - journal entries 123–4
 - journalising business transactions 119–20
 - journal voucher 91
 - judgement 80
 - labelling 216
 - language and communication skills 12
 - lead time 313

- ledger accounts 49–60, 63, 246, 249
 - analysing transactions 53–5
 - balancing 71
 - and chart of accounts 119
 - in columnar format 68–70
 - expenses 58–9
 - preparation of 63–70
 - revenues 56–7
 - in service business 166
- ledgers 169 *see also* general ledger; subsidiary ledgers
- legal factors 20
- liabilities 6, 7, 26–7, 124, 252
 - assets and 6
- limited liability 14
- line charts 215
- liquidation 80
- liquidity 319–21
 - measures of 331–2
- long-term assets 42, 136

- macros 207
- magic number 308–309
- managerial accounting 20
- manually generated 80
- materiality 80
- menus and graphical interfaces 159
- mixed reference (spreadsheets) 207
- modern accountant 12
- monetary principle 79
- money 308
- Motor Vehicles account 96
- multi-factor authentication (MFA) 159
- MYOB AccountRight (general journal entries) 164–8, 284
 - entering transactions 166–7
 - reports 167–8
 - setting up 164–6
- MYOB AccountRight (trading business with GST using subsidiary ledgers) 193–204, 284
 - Accounts command centre 202
 - Banking command centre 197–8
 - entering transactions through the menu option 197–8
 - Inventories command centre 201
 - Purchases command centre 198–9
 - reports 202
 - Sales command centre 200
 - setting up 194–7

- narrative form 32
- net assets 6
- net profit and cash 4
- net profit ratio 327–8
- no goods and services tax (no GST) 89–90
- non-current assets 42, 136, 181
- non-profit organisations 15
- note taking 13
- Nugun's system of accounts 136

- Office of the Registrar of Indigenous Corporations (ORIC) 15
- omission of specialised journals 162
- online bank payment screen 82
- online/desktop 159
- operating activities (cash flows) 4, 42
- operating flows 7

- operating speed 156
- operating system 155
- optical character recognition (OCR) 154
- oral communication skills 12
- order form 313
- organisational governance 10
- original invoice 90
- outline notes 13
- outward movements of goods 126
- over accounts payable 305–6
- overstocking 311
- owner's equity accounts 27, 52, 58, 100, 279

- paper-based documents 80
- Partnership Act 1891* 14
- partnerships 14
- pay bills 198
- paying expenses 122–5
- people 156
- periodic inventory system 182, 250
- perpetual inventory system 126, 129, 182
 - advantage 188
 - advantages of 192
 - GST-free and 188
 - using inventory subsidiary ledger 187–91
- personal use 137
- physical controls and security 296
- picking list 314
- pie charts 215
- planned figures 11
- point-of-sale applications 159
- posting 64, 68
- prepaid advertising 250
- prepaid expenses 249–52, 266
- preparation
 - of adjusted trial balance 254–6
 - Bank Reconciliation Statement 234
 - of columnar ledger accounts 68–70
 - of end of period reporting 267–84
 - of financial statements 257–9
 - general journal 93
 - Statement of Cash Flows 235–40
 - Statement of Financial Position 230–3
 - Statement of Profit or Loss 227–9
 - T ledger accounts 64–5
 - trial balance 70–1
- prepayments 249–53
- processing transactions, fundamentals
 - ledger accounts 49–60
 - preparation of ledger accounts 63–70
 - summary of rules for recording transactions 60–3
 - trial balance 70–4
- professional accounting 17
- profitability 319–21, 327–9
- profit and cash 41
- Profit and Loss Statement 39
- profit determination 225–7
- Profit or Loss Summary account 260, 262
- programming language 155
- pronouncements 17
- proper authorisation 305
- proper documentation 116
- property trusts 15

- Proprietary Limited (Pty Ltd) 15
- proprietary (or private) companies 15
- proprietorship *see* owner's equity accounts
- protecting (locking) 207
- public accountants 16, 19
- public company 40
- public sector organisations 15
- purchase of assets 136
- purchase order 313
- purchases 90
- Purchases command centre 198–9
- purchasing 120–1
- purchasing inventories 126–7

- rate of turnover of inventories 331
- ratio analysis 327
- raw materials 181
- REALOE 63
- real-world accounting systems 161–3
- receipt 84
- receipt copy 84
- receive money 197
- Reckon 158, 193
- Reckon Accounts Plus 81
- reconciliation, cash register 84, 85
- record and post balance day adjustments 246
- recording 301
- recording cash 84
- recording cash payments 86–9
- recording cash receipts 83–6
- recording transactions, summary of rules for 60–70
- record journal entry 167
- records 296
- registered business entities 113–15
- relative reference (spreadsheets) 207
- reliable, competent personnel 295
- Rent Revenue account 252, 253
- reorder point 313
- reorder quantity 313
- reports 167–8
 - accounting reports 10
 - analysis and interpretation of 325–37
 - audit report 17
 - formal accounting reports 10
 - general purpose reports 10, 11
 - for goods and services tax (GST) 115–19
 - MYOB AccountRight 167–8, 202
 - special purpose reports 11
- research 18
- responsibility, internal accounting controls 295
- retail or wholesale business 194
- retained earnings 7
- return on owner's equity 279, 329
- revenues
 - accrued 248–9, 265–6
 - definition 38
 - ledger accounts 56–7
 - service fees 57
 - unearned 252–3, 266–7
- reversing entries 264–7
 - accrued expenses 264–5
 - accrued revenues 265–6
 - prepaid expenses 266
 - unearned revenues 266–7
- rotation of duties 295–6
- rules for recording accounting 62
- rules of accounting 62

- sale of goods 38
- Sales account 129, 139
- Sales command centre 200
- sales of inventories 129–30, 314–315
- sales returns and allowances 130–1
- scaling 216
- security 159, 316
- security and privacy 159
- selling price element of transaction 129
- selling services 121
- separation of duties 296, 305
- sequence of processing 161
- service fees 38
- service fees revenue 57
- shareholders 14
- software 155–6 *see also* accounting software
- software packages 20
- sole traders (sole proprietors) 13–14
 - analysis and interpretation of reports 325–37
 - and public company 40
 - ratio analysis 327
 - vertical analysis 325–7
- source documents 80–92, 94
 - actual printed 83
 - bank statement as 86
 - credit purchases of items (no GST) 89–90
 - credit sales of goods and services (no GST) 89–90
 - examples 83
 - and general journal 91
 - important 83
 - internal transactions and adjustments 91
 - need for 83
 - producing and transmitting 80
 - used for recording cash payments 86–9
 - used for recording cash receipts 83–6
- specialisation, areas of 16
- specialised journals 92–93, 162
- special purpose reports 11
- specific identification method 183
- speed and accuracy of processing 161
- spend money 197
- spreadsheets 204–17
 - and accounting packages 284–9
 - business graphics in 213–17
 - features 206–8
- stacked bar charts 214
- statement of account 302, 314
- Statement of Cash Flows 4, 40–4
 - illustrative example of 6, 7, 240–5
 - preparation and presentation 235–40
 - purpose of 7
- Statement of Financial Position 4, 16, 32, 311
 - accounting equation and 32–7
 - illustrative example of 5–7, 240–5
 - inventory costing methods 182
 - preparation and presentation 230–3
 - as result of transactions 34–7
 - vertical analysis of 326

- Statement of Profit or Loss 4, 40–1
 - definition 39
 - illustrative example of 5, 6, 240–5
 - inventory costing methods 182
 - preparation and presentation 227–9
- statements of account 301, 302
- stewardship function 19
- stock item records 184–5, 187–9
- stockouts 311
- stocktaking (physical stocktake or physical inventory) 312–13
- storage 159
- streaming applications 159
- subsidiary ledgers 169
 - for accounts receivable and accounts payable 170–8
 - advantages 178–81
 - inventory 187–91
- supplies 112, 120–1
- Supplies account 182
- Supplies\Consumable Supplies 182
- system software 155

- taxable supplies 112
- Tax File Number (TFN) 114
- tax invoices 90, 116–18, 301, 314
 - for mixed supplies 117
 - and other documents 116–18
- technology trends 20
- Telephone Expenses 122
- template 204
- T form 32
- T ledger account format 49–50
- T ledger accounts
 - balancing 66–7
 - preparation 64–5
- trading entities 126
- trading organisation, financial statements for 267–84
- Transaction Journal 167

- transactions
 - effects on 34
 - with goods and services tax (GST) 120–47
 - internal 91
 - ledger accounts 53–5
- trial balance 70–4, 125, 134
 - errors not disclosed by 71
 - function of 70
 - locating errors 72
 - preparation 70–1
- trustees 15
- trusts 15
- turnover of inventories 316, 331
- two-column general journal 93

- unearned revenues 252–3, 266–7
- unethical conduct 20
- unlimited liability 14
- unpresented cheque 89

- verification 295
- vertical analysis 325–7
- Virtual Private Network (VPN) 83
- VISICALC 204

- wages account 59
- Wages and Salaries account 246
- weighted average cost method 184–6, 189, 200
 - ledger and inventory shortage
 - using 188–9
- wholesale business 194
- Wilson Enterprises paying Bracken Distributors 82
- workbook 204, 205
- worksheet 204, 205
- written communication 12

- Xero 193

CHART OF ACCOUNTS

1 Revenues		3 Assets	
11 Operating Revenue		31 Current Assets	
1101 Sales		3101 Petty Cash	
1101A Sales Returns and Allowances		3102 Cash in Hand	
1102 Service Fees Revenue		3103 Cash at Bank	
1103 Commission Revenue		3104 Accounts Receivable Control	
1104 Dividends Revenue		3104A Allowance for Doubtful Debts	
1105 Interest Revenue		3105 Other Receivables	
1106 Rent Revenue		3106 Inventories	
1107 Gain on Sale of Non-current Assets		3107 Supplies	
1108 Bad Debts Recovered		3108 Accrued Revenues	
		3109 Prepaid Insurance	
		3110 Prepaid Expenses	
2 Expenses		32 Other Financial Assets	
21 Cost of Sales		3201 Bonds	
2101 Buying Expenses		3202 Debentures	
2102 Cartage on Purchases		3203 Loans	
2103 Customs Duty		3204 Shares	
2104 Packaging Expenses		3205 Cash Investment	
2105 Cost of Goods Sold		33 Property, Plant and Equipment	
2106 Inventory Adjustment		3301 Furniture	
22 Cost of Services		3301A Accumulated Depreciation on Furniture	
2201 Supplies Expense		3302 Delivery Vehicles	
23 Selling Expenses		3302A Accumulated Depreciation on Delivery Vehicles	
2301 Advertising		3303 Motor Vehicles	
2302 Cartage on Sales		3303A Accumulated Depreciation on Motor Vehicles	
2303 Delivery Vehicle Expenses		3304 Equipment	
2304 Depreciation on Delivery Vehicle		3304A Accumulated Depreciation on Equipment	
2305 Sales Salaries		3305 Buildings	
2306 Sales Commission		3305A Accumulated Depreciation on Buildings	
24 Administrative Expenses		3306 Land	
2401 Accounting Fees		34 Intangibles	
2402 Consultancy Fees		3401 Goodwill	
2403 Depreciation on Buildings		3402 Patents	
2404 Depreciation on Equipment		35 Other Non-current Assets	
2405 Depreciation on Furniture		3501 Other Receivables	
2406 Depreciation on Motor Vehicles			
2407 Electricity		4 Liabilities	
2408 Insurance		41 Current Liabilities	
2409 Motor Vehicle Expenses		4101 Accounts Payable Control	
2410 Office Expenses		4102 Other Payables	
2411 Office Wages and Salaries		4102.1 GST Clearing (Payable)	
2412 Postage		4102.2 GST Collected	
2413 Rates		4102.2A GST Credits Received	
2414 Rent Expense		4103 Short-term Loan	
2415 Repairs and Maintenance		4104 Accrued Expenses	
2416 Stationery		4105 Unearned Revenues	
2417 Sundry Expenses		42 Non-current Liabilities	
2418 Superannuation Expense		4201 Loan	
2419 Telephone and Internet Expense		4202 Mortgage	
2420 Travel Expenses			
2421 Wages and Salaries		5 Owner's Equity	
2422 Loss on Disposal of Non-current Assets		5101 Capital	
25 Finance Expenses		5101A Drawings	
2501 Bad and Doubtful Debts		5102 Profit or Loss Summary	
2502 Bank Charges			
2503 Credit/Debit Card Fees			
2504 Interest Expense			

Individual accounts receivable and accounts payable are differentiated by adding extra digits after the main account number – that is, 3104 and 4101, respectively. Where A appears after an account number, this indicates a negative item.

Flexible online learning designed to support you

Nelson MindTap puts **you** at the centre

Access resources and content that make learning simpler yet smarter to help you go beyond drill and practice.



Develop your understanding through the wide range of weblinks.

Revise using quizzes to practice your skills and build your confidence.

Navigate your own path, accessing the content and support you need whenever you need it in your learning journey.

Find everything you need to access your Nelson MindTap course at
cengage.com.au/nelsonmindtap

 Nelson MindTap

ISBN 978-0170481144



9 780170 481144