

Essential Insight – Practical Guide Unit 4

Accounting and Finance Year 12 ATAR

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<p>Resource Hub Link: https://www.eibooks.com.au/acf</p> <ul style="list-style-type: none"> • Worked solutions to all questions. • Learning and Teaching Resources that align with book chapters. • SCSA Syllabus categorised to align with book chapters. • Current Sponsorship Opportunities • Community Partnership Opportunities • + Much more 	
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Accounting and Finance has components which are theoretically focused, and others which are primarily practically focused with some supporting theory. The table below breaks down what each textbook includes and how these can be used.

Textbook	This textbook includes:	This textbook is useful for:
Course Guide	<ul style="list-style-type: none"> • Theory for the theory-focused chapters of the course. • Student review questions for the theory focused chapters to assist student mastery of theory and useful for revision prior to assessments. • Key summary information from the practically focused chapters. <p>Note: Elaborated step-by-step explanation of practical chapters with practical review questions are included in the Practical Guide.</p>	<ul style="list-style-type: none"> • Student learning and teaching of theory chapters with practice questions. • Revising both theory and practical chapters when completing practice questions or revising prior to assessments. <p>Note: This textbook is similar in nature to a revision guide for the entire course, but it is also adequate for the learning and teaching of the theory chapters.</p>
Practical Guide	<ul style="list-style-type: none"> • All practical and theory for practical-focused chapters. • Step-by-step worked examples and practice questions to scaffold students from initial concept attainment to exam level. <p>Note: Chapters which are primarily theory-focused are included in the Course Guide.</p>	<ul style="list-style-type: none"> • Student learning and teaching of practical content-adjacent to relevant theory. • Student practice of practical chapters.
Exam Guide	<ul style="list-style-type: none"> • SCSA Year 12 exams categorised to match the chapters of the course and practical guides. 	<ul style="list-style-type: none"> • Student practice of exam questions at the end of all chapters of the textbook and prior to assessments.

These textbooks have been written succinctly whilst also covering all necessary content and skills required from initial concept attainment to exam level. The thorough nature of this book provides confidence that this resource contains all skills and content needed to achieve top ATAR results. The succinct nature of these textbooks is designed to assist with reducing barriers for all students. This succinct nature should also allow students to spend less time taking notes and more time applying higher order skills to gain mastery.

There are several research tasks throughout the textbooks that allow students to develop research skills and the ability to decipher paragraphs of text to apply relevant skills. These can also be adapted to be used as assessment project tasks.

A PDF copy of the textbook is available for teachers for use of projecting the textbook during class. If interested, please contact the email address on the Resource Hub linked on this cover page.

Chapters	
Unit 3	Unit 4
1. Introduction to Management and Financial Accounting	13. Accounting Standards
2. Internal and External Audit	14. AASB Conceptual Framework for Financial Reporting
3. Internal Control and Asset Management	15. Companies
4. Insolvency	16. Regulatory Bodies
5. Sources of Finance	17. Corporate Social Disclosure (CSD)
6. Investment Options	18. Cash Flows
7. Corporate Social Responsibility (CSR)	19. Key Performance Indicators (KPIs)
8. Cost Accounting	20. Ratios
9. Cost-Volume-Profit Analysis (CVP)	
10. Budgets	
11. Business Planning	
12. Capital Investment	

Chapters highlighted in blue are theory-focused chapters. Chapters highlighted in green are practical-focused chapters.

Foreword from Chartered Accountants Australia & New Zealand To Essential Insight Accounting and Finance Students

What does it mean to be an accountant?

If you're reading this, you already have an aptitude or interest in numbers and problem solving, but accounting careers are about so much more than that.

While the subjects you choose during high school will help you shape your futures, the beauty of accounting is that its relevant to any career you choose.

Accountants are woven throughout the global economy. A career in accounting opens doors in just about every corner of the world, across sectors, industries and businesses of every size.

Indeed, we'd like to tell you that accounting offers you a pathway to turn your passions into a career because it's hard to think of an industry or sector that doesn't have an accountant helping guide the big decisions.

Behind every athlete, every business big or small, every brand you love, every game you lose yourself in, there are financial experts making epic things possible. As an accountant, you're the go-to problem solver, using your money smarts and business skills to help your company or clients reach their goals.

And for the foreseeable future, there's huge demand for accountants. If you're seeking job security, global experiences, excellent earning potential, a dynamic lifestyle, influence, and you thrive on challenges, accounting could be your pathway to a fulfilling, impactful and epic career.

If you're interested in learning more about careers in accounting, we've teamed up with Year 13 to show you there's more to accounting than meets the eye. Visit year13.com.au/academy/business-class to learn more and consider joining our student membership program at cacanz.com/epic-future.

Until we see you in the accounting profession, continue to be passionate about your studies and dream big!

Samantha Wilson FCA
General Manager, CA Program



Why a career in accounting is the ultimate flex



You're at the heart of every business

Behind every athlete, every business big or small, every brand you love, and every game you lose yourself in, there is a financial expert making epic things possible.

As an accountant, you're the go-to problem solver, using your money smarts and business skills to help your company or clients reach their goals. It's about putting together clues to create a plan for the business, looking at the big picture, and coming up with a clever strategy for success.

You can be whatever you want

Accounting can open the door to just about any industry your heart desires. Imagine being the mastermind behind the next big social media sensation, the genius orchestrating live events and music festivals, or a change-maker in a not-for-profit organisation.

Explore exciting fields like sports, entertainment, gaming and tech. You could even roll with big names like Disney, Nike, and YouTube.

The top 10 perks of accounting

- 1. Job security:** You'll always be hot property.
- 2. Awesome earning opportunities:** Live the good life earning the big bucks.
- 3. Travel the world:** With skills as your passport, the world's your oyster.
- 4. Work in any industry:** Pursue your passions.
- 5. Fresh opportunities:** New gigs are always popping up.
- 6. Varied roles:** On the roles buffet, pick your fave flavour.
- 7. Climb high:** Follow the footsteps of big-shot CEOs.
- 8. Earn respect:** This career's got major street cred.
- 9. Transferable skills:** Pack up your skills and take them to any industry you fancy.
- 10. Life-work balance:** Live your best life while enjoying an awesome career.



Unlock a world of opportunities and skills



Accounting is your ticket to freedom

In Australia and New Zealand, accounting is one of the largest professions and is where the cash is at. Grads pull in an average annual salary* of \$60,000. But CA-certified pros? They're cashing in up to \$175,000 (oh yeah!).** The best part? You can work anywhere in the world – in your dream industry.

Less number crunching, more epic

AI's got your back. It's transforming the way modern accountants work. Now you can focus on the exciting stuff – you're a data wizard, insights detective, and strategic mastermind!

Skills that can take you anywhere!

Do you dream of growing a side hustle, becoming an entrepreneur, or a champion for social justice? Accounting skills can make it happen.

- Be a problem-solving pro
- Hone your decision making game
- Polish your people skills
- Level up on logic and fairness
- Be money wise in business and life

* Indicative average only – exact salary will depend on location, industry, and role. Hays Salary Guide FY23/24 Accounting and Finance.

** Data obtained for senior qualified accountants in managerial roles in Queensland, Australia. Hays Salary Guide FY23/24 Accounting and Finance.

TIP: Accounting skills like *problem-solving, negotiation, and analytical thinking, can help you get ahead both in your career and your life.*

Real accountants (CAs) making epic things happen



Meet Amanda Gore CA

Crime Fighter

Founder and Director of The Centre for Global Advancement (C4GA).

- She's a real-life crime fighter based in Kenya.
- Combats wildlife and environmental crime by following money trails.
- Travels globally training authorities to detect and investigate financial crimes.
- Is passionate about helping the planet.



Meet Rishabh Tandon CA

Business Trailblazer

Music Licensing Expert at YouTube.

- He's Aussie-born, and now lives and works in New York City.
- Collaborates with music artists, songwriters, and creators.
- Ensures musicians get rewarded for their creativity.
- Has turned his passion for music and travel into a career.



Meet Rebecca Glover CA

Community Empowerer

Senior Finance Director at World Vision.

- She works for the world's biggest humanitarian organisation.
- Ensures World Vision's resources are put to their best use.
- Finds working in a not-for-profit to be incredibly fulfilling.
- Is driven by her passion to create a brighter, better world.

What's next? Uncover the steps for an epic future

1

Get a head start

There are no prerequisites you need to study in high school. But diving into subjects like business, enterprise studies, accounting, agriculture, maths, technology, economics, and science, can help you get ahead of the game!

2

Explore your interests

Discover the ins and outs of the businesses, brands and causes you're passionate about.

3

Gain practical experience

Ask to do some interning at a local business. Some places take high school students as 'cadets', so you could kick-start your career right from high school.

4

Complete high school

Do your HSC (AU) or NCEA (NZ).

Study accounting

Apply for and complete an undergraduate qualification, such as a Bachelor of Accounting, Bachelor of Business or Commerce with a major in accounting. Or consider an accounting or business diploma from a Polytech or TAFE, or other government-registered higher education provider.

5

6

Start your career

Make epic things happen in an industry you love.

Boost your career

In today's fast-paced world, professionals need an edge, and the CA Program's globally recognised qualification provides exactly that.

7

TIP: Look into programs like the Year13's Virtual Work Experiences to get a taste of the business world and the skills that'll help you succeed.

Top tips from accounting students



Mitchell

"It's remarkable how many CEOs and directors of large companies are Chartered Accountants. Studying accounting can lead you to incredible opportunities."

Bachelor of Business and Accounting student at Monash University, Australia.

"I understand the pressure of making a career choice in high school. Gather as much information as possible to make an informed decision. Attend information nights or networking events. Now's the best time to explore all your options."

Bachelor of Commerce (Accounting and Finance) student at the University of Auckland, New Zealand.



Kjirsti



Benjamin

"With accounting skills you could work in London in a big corporate firm, or stay local and support small businesses. Clarify your goals, dreams and ambitions, then pursue your degree and work hard. When you look up, you'll find you have all you want and more."

Bachelor of Commerce (Accounting and Taxation) student at the University of Canterbury, New Zealand.



TIP: Have questions? Ask us anything or request a school visit from our awesome speaker squad (CAs and accounting students) to share their real-world stories and insights.

How to become Financially Independent and Retire Early (FIRE) for Essential Insight Accounting and Finance Students



Dave Gow, author of Strong Money Australia.

Who am I?

Hi, my name is Dave Gow from Perth, Western Australia. I became financially independent and retired at the age of 28. My partner and I achieved financial independence whilst working regular jobs with yearly incomes of around \$75,000 and without going to university. What allowed us to achieve FIRE was the application of strong, tried and tested, financial principles. Now that I'm financially independent I have the freedom to pursue my passions such as environmental volunteering and helping others learn about how to use their money to create freedom. I do this through my book, blogs and podcasts, and articles written for leading investment platforms.

Tim Coveney, the author of the ACF ATAR book you are reading, told me that many ACF ATAR students are interested in the idea of becoming financially independent and possibly having the option to retire early. Whilst the ACF ATAR course doesn't specifically teach financial independence, studying financial independence will help build your financial literacy skills and be useful personally and professionally. I have created a range of resources to share with you on the following links which will help bridge the gap between what you learn while studying ACF ATAR and FIRE.

Resource links

The below resources are designed to help you start your journey learning about FIRE. You may enjoy discussing these concepts with your teachers, parents and friends.

	Beginner's Guide to FIRE	Strong Money Australia Book
QR Code		
Link	https://strongmoneyaustralia.com/beginners/	https://strongmoneyaustralia.com/book/
Description	Here you'll find everything you need to know about how to start working towards financial independence. Articles, podcasts, Q&A, and free eBooks.	Dave's book shares the complete roadmap to reaching financial independence in Australia. Available in paperback, eBook, and audiobook.

How can learning about FIRE help high school Accounting and Finance ATAR students?

There are many reasons why Accounting and Finance students should prioritise learning about financial independence. Achieving financial independence is not just about earning, it is about managing resources wisely and creating a sustainable financial future. Financial independence is essentially the ability to cover your living expenses without relying on a regular paycheck. By understanding the principles of financial independence students can develop a roadmap to achieve their own financial goals, such as buying a home, starting a business, and maybe even early retirement. This knowledge empowers you to take control of your financial future and make thoughtful decisions that give you more control over your life.

As accounting and finance students, the skillset you develop uniquely positions you to navigate the complexities of personal finance with precision and essential insight.

We all have to navigate the complexities of finance, such as loans, investments, superannuation, and money management. Learning about financial independence and wealth creation equips you with the mental and practical skills to make better financial decisions that align with your goals and avoid costly mistakes.

Understanding personal finance puts you way ahead of the game. You're able to move forward with confidence, and make informed decisions based on the knowledge you've gained. And as you build that strong foundation, you ensure a bright future in an area that most people struggle with. You can spot opportunities, overcome financial hurdles, and move through life with greater certainty.

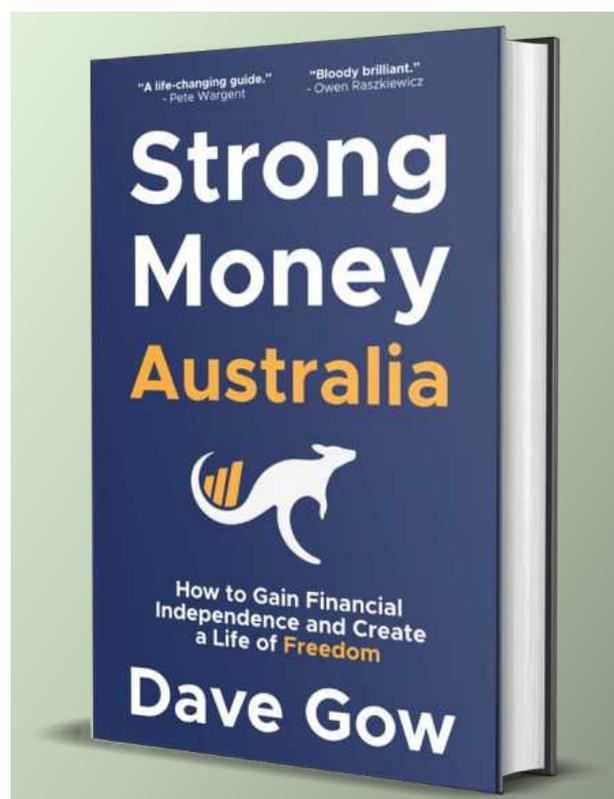
As future professionals in finance, you may be entrusted to advise others on similar matters. Acquiring expertise in the growing field of financial independence equips you to provide valuable guidance to clients, colleagues, or businesses.

But more than that, pursuing financial independence on a personal level gives you a profound sense of security, enabling you to pursue professional and personal goals with confidence. In essence, Integrating financial independence education into your studies benefits you personally, and also prepares you to be a well-rounded and capable financial professional.

Embrace the journey toward financial independence and let your financial acumen serve as a cornerstone for a secure and fulfilling future.

Wishing you all the best for your future studies,

Dave Gow
Strong Money Australia



Strong Money Australia by Dave Gow.
A book on How to Gain Financial Independence and Create a Life of Freedom.



Contents

Syllabus – Unit 4	11
15. Companies	13
Companies – Syllabus.....	14
Companies – Introduction	15
Companies – Theory	15
General Purpose Financial Reports Introduction	28
GPFR journal and ledger entries.....	29
Share issue and share issue costs.....	29
Retained Earnings and Dividends.....	39
Bonus share issue.....	53
General Reserve and Retained Earnings.....	60
Asset Revaluation Reserve.....	66
Statement of Changes in Equity	69
Statement of Comprehensive Income	90
Balance Day Adjustments Revision	93
Statement of Financial Position.....	103
Notes to the Statement of Financial Position	107
18. Cash Flows	134
Cash Flows – Syllabus.....	135
Cash Flows – Introduction	135
Statement of Cash Flows – Introduction and Summary Table	135
Preparation and Interpretation of a Statement of Cash Flows without reconstructions	136
Other Theory – Statement of Cash Flows	150
Reconstructions	155
Reconstructions – Accounts Receivable and Allowance for Doubtful Debts	156
Reconstructions – Inventory and Accounts Payable	162
Reconstructions – Income Tax Payable	168
Reconstructions – Retained Earnings	173
Reconstructions – Share Capital.....	179
Reconstructions – Prepaid Expense.....	184
Reconstructions – Accrued Expense	188
Reconstructions – Accrued Income	193
Reconstructions – Sale and Purchase of Non-Current Assets.....	198
Reconstructions – Hidden cash expenses relating to Sale and Purchase of Non-Current Assets	206
Reconstructions – Unearned Income / Income Received in Advance.....	214
Reconstructions – Preparation of Statement of Cash Flows using Reconstructions	218
20. Ratios	234
Ratios – Syllabus.....	235
Ratios – Introduction	236
Ratio Skill Check	238
Efficiency Ratios	241
Debtor's Collection.....	241
Inventory Turnover / Stock Turnover	244
Gearing / Leverage / Stability Ratios.....	250
Debt to Equity Ratio.....	250
Liquidity Ratios	256
Working Capital Ratio / Current Ratio.....	256
Quick Asset Ratio / Acid Test Ratio.....	259
Profitability Ratios	264
Profit Ratio.....	264
Rate of Return on Assets Ratio	267
Times Interest Earned.....	269
Market Ratios	275
Earnings Per Share	275
Price / Earnings.....	278
Dividend Yield	280
Ratios – Other theory	285

Syllabus – Unit 4

Syllabus – Unit 4	
Accounting Standards	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • the purpose of accounting standards in: <ul style="list-style-type: none"> ▪ protecting external users ▪ assisting directors in discharging their obligations ▪ providing confidence to investors in Australian capital markets
AASB Conceptual Framework for Financial Reporting	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • the purpose of the <i>Conceptual Framework</i> and its key elements <ul style="list-style-type: none"> ▪ the nature of the reporting entity ▪ the objective of general purpose financial reports ▪ evaluation and application of the fundamental and enhancing qualitative characteristics of financial information ▪ evaluation and application of asset, liability, income and expense recognition criteria
Companies	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • characteristics of public and large proprietary companies <ul style="list-style-type: none"> ▪ liability of owners ▪ number of members and directors ▪ continuity of existence ▪ legal entity ▪ transferability of ownership ▪ separation of ownership and management <p>Government and the community: The role and influence of governments and other bodies</p> <ul style="list-style-type: none"> • the purpose and nature of the <i>Corporations Act 2001</i>, and its impact on company formation and operations <ul style="list-style-type: none"> ▪ powers and duties of directors ▪ a written constitution ▪ replaceable rules ▪ prospectus ▪ rights of shareholders <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of the general journal and general ledger for the following: <ul style="list-style-type: none"> ▪ issue of ordinary shares payable in full on application ▪ bonus share issues ▪ interim and final dividends (recommended, declared or paid) ▪ share issue costs • preparation of the retained earnings ledger account, including: <ul style="list-style-type: none"> ▪ profit or loss ▪ dividends ▪ transfers to and from reserve accounts ▪ debit or credit opening balances <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of financial statements in accordance with the <i>Conceptual Framework</i> and in accordance with the standards <ul style="list-style-type: none"> ▪ statement of comprehensive income (one statement version only) ▪ statement of financial position ▪ statement of changes in equity <ul style="list-style-type: none"> ○ retained earnings ○ equity ○ share capital ○ reserves • notes to financial statements/notes to accounts, limited only to: <ul style="list-style-type: none"> ▪ share capital ▪ other components of equity ▪ property, plant and equipment ▪ dividends <p>Note: preparation of the above financial statements is restricted to the following issues:</p> <ul style="list-style-type: none"> • revaluation of property, plant and equipment: non-depreciable assets only • cash dividends • bonus share issues • transfers to or from general reserve • preliminary expenses • issue of ordinary shares, including share issue costs • purpose and nature of the following balance day adjustments: <ul style="list-style-type: none"> ▪ accrued expenses ▪ prepaid expenses/stock of supplies ▪ accrued income ▪ income in advance ▪ doubtful debts ▪ depreciation • for the purpose of calculating income tax expense, profit before tax is deemed to equal taxable income
Regulatory Bodies	<p>Government and the community: The role and influence of governments and other bodies</p> <ul style="list-style-type: none"> • the nature and importance of the following groups which regulate and influence the general purpose financial reporting of companies in Australia: <ul style="list-style-type: none"> ▪ the Financial Reporting Council (FRC) ▪ Australian Securities and Investments Commission (ASIC) ▪ International Accounting Standards Board (IASB) ▪ Australian Accounting Standards Board (AASB) ▪ Australian Securities Exchange (ASX) ▪ lobby groups
Corporate Social Disclosure (CSD)	<p>Government and the community: The influence of social, environmental and ethical factors</p> <ul style="list-style-type: none"> • the extent and nature of corporate social disclosure • the difficulties faced by accountants in producing social and environmental information • the use made of corporate social disclosure by the company and other users • critical evaluation of corporate social disclosure as made by Australian companies

Syllabus – Unit 4	
Cash Flows	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • Statement of Cash Flows as per AASB 107, including: <ul style="list-style-type: none"> ▪ benefits of the cash flow statement information ▪ concepts of cash and cash equivalents <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • cash flow statement from comparative balance sheets and income statements using the direct method only – notes not required and GST not included <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • interpretation of the movements in cash flow items
Key Performance Indicators (KPIs)	<p><i>Note: The below syllabus sections are in both the 'Ratios' chapter and 'Key Performance Indicators' chapter given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • examination and interpretation of annual reports, financial statements and stock exchange data to assess the position and performance of a public company • purpose of annual reporting and the use of key performance indicators by directors for accountability and decision-making purposes
Ratios	<p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of the following ratios – application of GST not required <ul style="list-style-type: none"> ▪ liquidity ratios <ul style="list-style-type: none"> ○ working capital/current ○ quick asset ▪ efficiency ratios <ul style="list-style-type: none"> ○ debtor's collection ○ inventory/stock turnover ▪ profitability ratios <ul style="list-style-type: none"> ○ profit ○ rate of return on assets ○ times interest earned ▪ leverage ratio <ul style="list-style-type: none"> ○ debt to equity ▪ market ratios <ul style="list-style-type: none"> ○ earnings per share ○ price/earnings ○ dividend yield <p><i>Note: Some of the below syllabus sections are in both the 'Ratios' chapter and 'Key Performance Indicators' chapter given the overlap in syllabus but distinctly different content/ examination questions.</i></p> <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • examination and interpretation of annual reports, financial statements and stock exchange data to assess the position and performance of a public company • purpose of annual reporting and the use of key performance indicators by directors for accountability and decision-making purposes • interpretation of the following ratios: <ul style="list-style-type: none"> ▪ liquidity ratios <ul style="list-style-type: none"> ○ working capital/current ○ quick asset ▪ efficiency ratios <ul style="list-style-type: none"> ○ debtor's collection ○ inventory/stock turnover ▪ profitability ratios <ul style="list-style-type: none"> ○ profit ○ rate of return on assets ○ times interest earned ▪ leverage ratio <ul style="list-style-type: none"> ○ debt to equity ▪ market ratios <ul style="list-style-type: none"> ○ earnings per share ○ price/earnings ○ dividend yield • limitations in assessing performance from financial statement analysis and from traditional financial accounting <ul style="list-style-type: none"> ▪ historical cost accounting ▪ lack of comparability between entities ▪ lack of disclosure

School Curriculum and Standards Authority, (2020). Accounting and Finance ATAR course Year 12 syllabus. The School Curriculum and Standards Authority does not endorse this publication or product.

15. Companies



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>Why would a business choose to operate as a company rather than a sole trader or partnership?</p>	
<p>What do you think is the difference between a 'private company' and a 'public company'?</p>	
<p>What rights do you think a shareholder should have regarding a business they owns shares in?</p>	

Companies	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • characteristics of public and large proprietary companies <ul style="list-style-type: none"> ▪ liability of owners ▪ number of members and directors ▪ continuity of existence ▪ legal entity ▪ transferability of ownership ▪ separation of ownership and management <p>Government and the community: The role and influence of governments and other bodies</p> <ul style="list-style-type: none"> • the purpose and nature of the <i>Corporations Act 2001</i>, and its impact on company formation and operations <ul style="list-style-type: none"> ▪ powers and duties of directors ▪ a written constitution ▪ replaceable rules ▪ prospectus ▪ rights of shareholders <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of the general journal and general ledger for the following: <ul style="list-style-type: none"> ▪ issue of ordinary shares payable in full on application ▪ bonus share issues ▪ interim and final dividends (recommended, declared or paid) ▪ share issue costs • preparation of the retained earnings ledger account, including: <ul style="list-style-type: none"> ▪ profit or loss ▪ dividends ▪ transfers to and from reserve accounts ▪ debit or credit opening balances <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • preparation of financial statements in accordance with the <i>Conceptual Framework</i> and in accordance with the standards <ul style="list-style-type: none"> ▪ statement of comprehensive income (one statement version only) ▪ statement of financial position ▪ statement of changes in equity <ul style="list-style-type: none"> ○ retained earnings ○ equity ○ share capital ○ reserves • notes to financial statements/notes to accounts, limited only to: <ul style="list-style-type: none"> ▪ share capital ▪ other components of equity ▪ property, plant and equipment ▪ dividends <p>Note: preparation of the above financial statements is restricted to the following issues:</p> <ul style="list-style-type: none"> • revaluation of property, plant and equipment: non-depreciable assets only • cash dividends • bonus share issues • transfers to or from general reserve • preliminary expenses • issue of ordinary shares, including share issue costs • purpose and nature of the following balance day adjustments: <ul style="list-style-type: none"> ▪ accrued expenses ▪ prepaid expenses/stock of supplies ▪ accrued income ▪ income in advance ▪ doubtful debts ▪ depreciation • for the purpose of calculating income tax expense, profit before tax is deemed to equal taxable income
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Companies – Introduction

Companies are a form of business ownership in Australia which are governed by the Corporations Act 2001. The practical skills regarding this companies chapter primarily focuses on the accounting processes required to prepare General Purpose Financial Reports (GPFRs) for use by external users.

Structure of this chapter

- Company Theory.
- Company Practical – Preparation of GPFRs:
 - General journal and general ledger entries required to prepare GPFRs.
 - Statement of Changes in Equity.
 - Statement of Comprehensive Income.
 - Statement of Financial Position.
 - Note: The Statement of Cash Flows is a GPFR but is covered in its own chapter due to the more complex nature of preparing this report.

Companies – Theory

Corporations Act 2001 – Nature, purpose

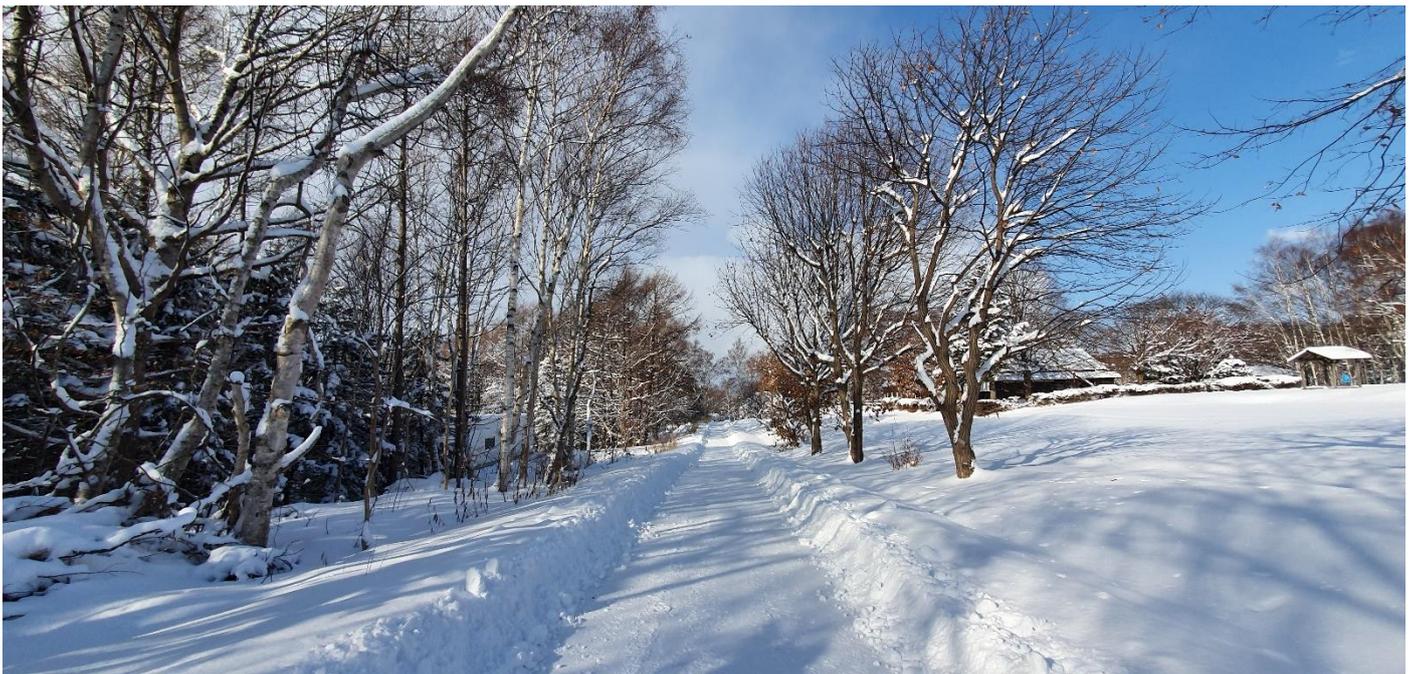
Corporations Act 2001	
Nature	Federal Australian legislation for business entities.
Purpose	<ul style="list-style-type: none"> • Primarily legislation is about companies. • Administered by ASIC. <p><i>The purpose of the Act includes company:</i></p> <ul style="list-style-type: none"> • Company types. • Legal existence. • Director duties. • External audit requirements. <p><i>Hint: think of things included in the company characteristics comparison table.</i></p>

Note: Corporations Act questions may ask about restrictions on company structures. This type of question is referring to the restrictions as per the company characteristics tables.

Companies – Public vs Private

- Public company – Open to investment from the public.
- Private company – Not open to investment from the public.
 - Small proprietary company.
 - Large proprietary company.

Note: More detailed comparison in following summary tables.



Historical village of Hokkaido, Sapporo.

Characteristics of Small and Large Proprietary Companies

	Small Proprietary Companies	Large Proprietary Company
Employees	Fewer than 100 employees.	If a proprietary company exceeds any two of the three criteria for small proprietary companies.
Consolidated revenue at the end of the financial year	Less than \$50 million.	
Value of consolidated gross assets at the end of the financial year	Less than \$25 million.	

Company characteristics comparison

Key	
	• Green = Two match.
	• 3 yellow = All Same.
	• 3 no colour = All different.

	Small Proprietary Companies (SPC)	Large Proprietary Companies (LPC)	Public Companies (PC)
Separate legal entity	Yes.	Yes.	Yes.
Limited liability (Main advantage)	Yes. Limited only to unpaid amounts owing on shares.	Yes. Same as SPC.	Yes. Same as SPC.
Continuity of existence	Yes.	Yes.	Yes.
Separation of ownership and members	Company is run by board of directors. Shareholders elect directors at annual general meeting.	Same as SPC.	Same as SPC.
Transferable ownership	Yes. Shares can be sold as per company constitution.	Yes. Same as SPC.	Yes. Shares can be sold without restriction.
Director(s)	At least one director who lives in Australia.	Same as SPC.	Minimum 3 directors, at least two must live in Australia.
Number of shareholders (members)	Minimum of 1 shareholder and a maximum 50 non-employee shareholders.	Same as SPC.	Minimum of 1 shareholder and no maximum shareholders.
Employees, revenue and gross profit	See table above.	See table above.	No restrictions.

Notes:

- The syllabus only requires characteristics of public and large proprietary companies regarding: 'liability of owners', 'number of members and directors', 'continuity of existence', 'legal entity', 'transferability of ownership', 'separation of ownership and management'.
- Further company characteristic comparison is on the following page and may fall under other syllabus dot points either directly or loosely.
- The above legislation is found in the Corporations Act.

Company characteristics – Further comparison

	Small Proprietary Companies (SPC)	Large Proprietary Companies (LPC)	Public Companies (PC)
Name	Requires "Proprietary Limited" or "Pty Ltd".	Same as SPC.	Requires "Limited" or "Ltd".
ASX Listed	No.	No.	Yes, optionally listed on ASX. Can either be listed or unlisted.
Access to capital / Issue of securities (shares or debentures)	Can raise funds from employees and existing shareholders.	Same as SPC.	Can raise funds from the public by issuing shares or debentures.
Annual General Meeting (AGM)	Not required.	Not required.	Required to hold AGM.
Constitution	Required to have a Constitution. ASIC lodgment of Constitution not required. Copy of Constitution must be kept in company's records.	Same as SPC.	Required. ASIC lodgment of Constitution required.
Financial statements audit	Only lodged or audited if requested by ASIC.	Required to prepare, audit and lodge GPFs with ASIC.	Same as LPC.
Director's report	Not required.	Required for ASIC and shareholders.	Same as LPC.
Shareholders dividends	Receive profits if dividend declared.	Same as SPC.	Same as SPC.
Tax rate	Flat tax rate.	Flat tax rate.	Flat tax rate.
Regulation / Legislative interference	Less than LPC and public companies.	More than SPC, less than PC. GPFs submitted to ASIC and shareholders.	More than LPC. GPFs submitted to ASIC and shareholders. Must comply with ASX listing rules.

Notes:

- The syllabus only requires characteristics of public and large proprietary companies regarding: 'liability of owners', 'number of members and directors', 'continuity of existence', 'legal entity', 'transferability of ownership', 'separation of ownership and management'.
- This table of company characteristic comparison may fall under other syllabus dot points either directly or loosely.
- The above legislation is found in the Corporations Act.

Share issue price

Public company shares are issued at:

- A price per share determined by directors.

Shareholder rights

Right	Ordinary Shareholders	Preference Shareholders
Dividends	No specific dividend rights.	Dividends paid before ordinary shareholders at a fixed rate.
Voting rights	Voting rights at AGM.	No right to attend or vote at AGM.
Liquidation repayment order	Last to receive liquidation payment.	Repayment may occur before ordinary shareholders during liquidation based on Constitution.
Share sale	Can sell shares without restriction.	Can sell shares without restriction.
Receive Annual Report	Yes.	Yes.

Replaceable Rules – Summary Table

	Replaceable Rules
Nature / Purpose	<ul style="list-style-type: none">• Basic rules outlining internal management processes of businesses.• Included in Corporations Act.• These are the default rules of a business if no custom company constitution has been created.
Deal with / Functions	<ul style="list-style-type: none">• Director appointment.• Director powers.• AGM processes.• AGM voting.• Shares.• Director salaries.

Company constitution – Summary Table

	Company Constitution
Nature	Rules to define internal management processes.
Purpose	<ul style="list-style-type: none">• Is not compulsory, 'replaceable rules' can be used instead of a company constitution.• Company constitution replaces the 'replaceable rules'.• Can modify the 'replaceable rules'.• Company constitution must be submitted to ASIC.
Covers / Function / Deals with	<ul style="list-style-type: none">• Shareholder rights.• Director powers.• AGM voting procedures.

Prospectus – Summary Table

	Prospectus
Nature	Prospectus of public company invites members of the public to purchase company shares or debentures.
Purpose / Function	<ul style="list-style-type: none">• Includes information that investors require to decide whether to purchase shares or debentures.• Aligns with Corporations Law requirements when making information public.• Prospectus available to public and lodged with ASIC and ASX.
ASIC registration	Required when shares in public company are offered to the public.
Information includes <i>Know any 3</i>	<ul style="list-style-type: none">• Where investor money will be spent specifically.• Future financial planning.• GPF information.• Directors and senior management details.• Company age.• Value and number of shares/debentures.• Minimum share subscription amount for security issue to proceed.

Directors – Duties.

- Act in good faith.
- Act with care and diligence.
- Avoid improper use of information.
- Avoid improper use of position.
- Disclose personal interests.
- Management of a public company.
- Dividend recommendation and approval.
- Awareness of company's position and performance.
- Not trade while insolvent.
- Ensure legislation compliance.

Note: Know any 4

Annual General Meeting (AGM) – Purpose

- Review performance.
- Shareholders can ask questions.
- Voting on key issues, such as:
 - Approval of GPFRs.
 - Director election/re-election.
- AGM formally resolved with director preparation and acceptance of Annual Report.

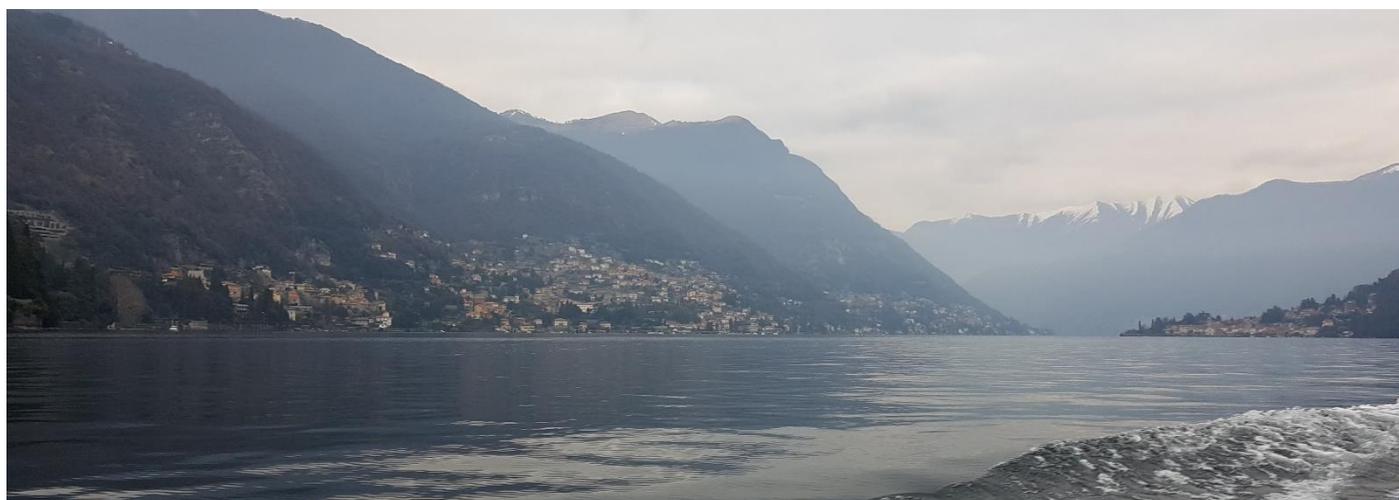
Impact of proprietary limited company becoming public company on manager's control

Changes managers control in the form of:

- Directors are now required to act in interest of all shareholders, not just themselves.
- Director ability to influence decisions is based on the number of shares owned.
- Control could be lost due to separation of owners and management.

Negative aspects of company characteristics

Negative aspect	Explain
Separation of ownership and management	<ul style="list-style-type: none">• Shareholders have ownership portion with no day-to-day management capacity.• GPFRs are the only insight into an entity before directors are elected.• Self-interest of directors or management could negatively impact shareholders.
Continuity of existence	<ul style="list-style-type: none">• Company survival depends on director ability to manage entity.• Insolvency can disrupt operations.• Liquidation ceases to operations.
Costs	<ul style="list-style-type: none">• High start up and running costs.
Regulation	<ul style="list-style-type: none">• Legislation influences operations and is expensive to comply with.

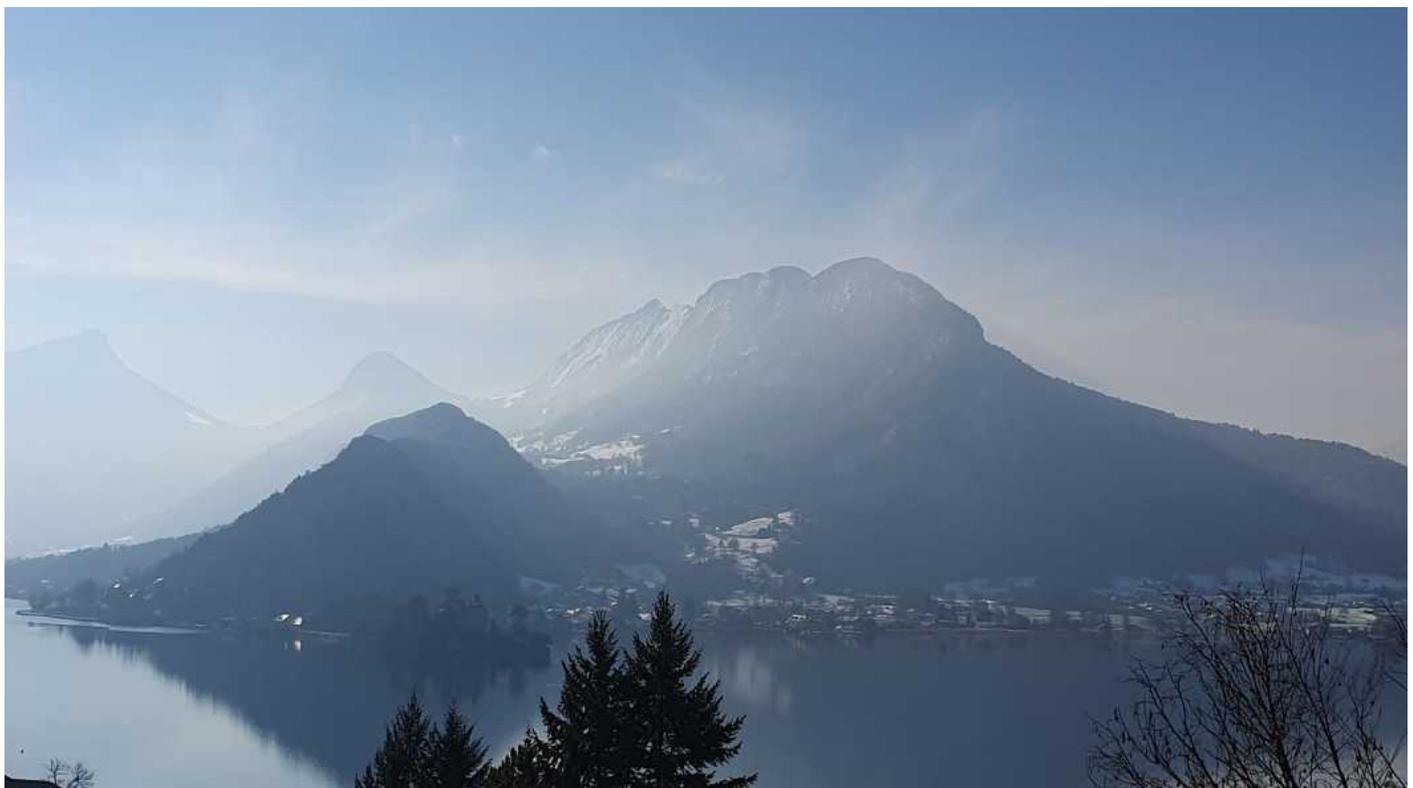


Lake Como, Italy.

Annual report – Additional items included, other than GPFs and notes to the accounts

Identify	Describe
External audit report	<ul style="list-style-type: none"> • Independent assessment of GPFs. • Concludes whether GPFs: <ul style="list-style-type: none"> ◦ Are a true and fair presentation of the company. ◦ Comply with legislation.
Director's report	<p>Provides review of company:</p> <ul style="list-style-type: none"> • Financial position. • List of directors and their remuneration. • Board of directors' changes. • Core goals. • Business strategies. • Review of previous year(s). • Future goals. <p><i>(Hint: think of Business Planning chapter.)</i></p>
CSD report	<ul style="list-style-type: none"> • Provides information regarding CSR obligations, goals and progress.
KPI report	<ul style="list-style-type: none"> • Reflects on performance relative to KPIs.
Corporate Governance report	<ul style="list-style-type: none"> • Must be produced by all companies listed on the ASX. • Report includes policies and processes that the entity follows and maintains.
A directors' declaration	<p>States that financial statements and notes to the accounts represent:</p> <ul style="list-style-type: none"> • A fair and true presentation of company. • Accurate preparation as per Australian Accounting Standards. • The company is solvent.

Note: This additional information is required for full disclosure. Know how to identify and describe any three. For each of those three any two description dot points is usually enough.



Annecy, France.

Practice Questions

Questions 1-20: Company theory introduction.

Exam Questions

See 'Companies' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Note: the practical component of the Companies chapter has not been covered yet, however, many theory questions can be practiced using the theory that has been covered so far.

Tip	<p><u>Course Guide</u> While completing this chapter you may find it useful to refer to the relevant chapter in the Essential Insight Course Guide. The Course Guide summarizes all theory relevant for each practical guide chapter. This saves time flipping through multiple pages in the Practical Guide while revising. The Course Guide can be found by navigating to the Resource Hub link on the front page.</p>
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Question 1

Identify which of the following proprietary companies and public companies do not have in common.

- a. Separate legal entity.
- b. Limited liability
- c. Number of directors.
- d. Continuity of existence

Question 2

Shares of a public company are issued at a price set by:

- a. The public.
- b. The shareholders.
- c. The government.
- d. The directors.

Question 3

Which of the following describes the rights of ordinary shareholders.

- a. No right to attend or vote at an annual general meeting.
- b. Last to receive liquidation payment.
- c. Dividends paid before ordinary shares at a fixed rate.
- d. Can sell shares with some restrictions.

Question 4

The company constitution does not deal with:

- a. Shareholder rights.
- b. AGM voting procedures.
- c. Director powers.
- d. External management processes.

Question 5

If a _____ does not exist for a company, then the replaceable rules are used by default instead.

- a. Annual general meeting.
- b. Prospectus.
- c. Company constitution.
- d. Director.

Question 10

Outline the purpose of the annual general meeting.

Question 11

Describe the nature and purpose of a company constitution.

Question 12

Describe the nature and functions of the replaceable rules.

General Purpose Financial Reports Introduction

Annual reports include a series of General Purpose Financial Reports (GPFRs) to provide information to stakeholders. These GPFRs include:

- Statement of Comprehensive Income.
- Statement of Changes in Equity.
- Statement of Financial Position.
- Statement of Cash Flows.

Note: While the statement of cash flows is also in GPFR, this is covered in its own chapter due to the many steps involved relative to other GPFRs.

Preparation of these GPFRs requires accounting processes to be performed which is covered in this chapter prior to the preparation of these statements.

General Purpose Financial Reports – Summary Table

Statement	Financial Position	Comprehensive Income	Cash Flows	Changes in Equity
Accrual or cash accounting	Accrual.	Accrual.	Cash.	Accrual.
Enables users to evaluate the company's	<ul style="list-style-type: none"> • Financial position. • Liquidity. 	<ul style="list-style-type: none"> • Performance. 	<ul style="list-style-type: none"> • Cash-related activities impact on cash position. 	<ul style="list-style-type: none"> • Changes in equity during the period.
Discloses / Measures and reports	<ul style="list-style-type: none"> • Assets. • Liabilities. • Shareholders' equity. 	<ul style="list-style-type: none"> • Profit or loss. • Other comprehensive income. • Comprehensive income. 	Cash related activities classified as: <ul style="list-style-type: none"> • Operating. • Investing. • Financing. 	<ul style="list-style-type: none"> • Total comprehensive income. Equity reconciliation of carrying amount between at the start and end of period for: <ul style="list-style-type: none"> • Profit or loss. • Other comprehensive income. • Owner contributions and distributions to owners.

Tip	<p><u>Course Guide</u> While first practicing preparing individual general journals, general ledgers or GPFR statements – have open the relevant example journals, ledgers or GPFR pages from the Course Guide. This will build familiarity and confidence with practical layout and preparation. The Course Guide can be found by navigating to the Resource Hub link on the front page.</p>
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GPFR journal and ledger entries

There are a series of general journal and general entries to account for company activities. In this section, the following accounting activities are demonstrated:

- Share issue and share issue costs.
- Payment of interim and final dividends.
- Bonus share issue.
- Transfers to and from retained earnings to the general reserve.
- Asset revaluation.

Reserves

During this chapter, reserves are introduced. Reserves are equity items other than share capital. The three types of reserves covered in this course are:

- Retained Earnings.
 - Profits are transferred to retained earnings at the end of the financial year.
 - Dividends are paid from retained earnings.
 - These are covered in more detail in another section.
- General Reserve.
 - A general reserve is created by a company to set aside funds for future use. Funds can be transferred to or from the general reserve from retained earnings.
- Asset Revaluation Reserve.
 - An asset revaluation is created when the value of a non-current asset increases above the historical cost of the asset recorded on the balance sheet.

Share issue and share issue costs

Companies issue shares to raise capital. There are a series of general ledger and journal entries required to record the issue of shares and the costs of issuing shares.

Example

- On 20 August 2027, a prospectus was issued by a company for 45,000 ordinary shares at an issue price of \$1 per share.
- By 28 August 2027, applications had been received for 39,000 shares.
- On 3 September 2027, shares were allotted by the directors and share issue costs of \$2,800 were paid on the same day.

Required task:
Prepare the general journal and general ledger to record the issue of shares and share issue costs.

Solution Part 1: Issue of shares payable in full on application

Step 1 – Application money received.

There is no general journal or ledger entry for the initial prospectus. The first entry occurs on the date the money for the applications is received. In this example, not all shares were purchased, however, it is possible for applications to be received for the entire prospectus.

- Debit Cash at bank \$39,000 to increase this asset account.
- Credit Application \$39,000 to increase this liability account. This is a liability account as the company is required to issue shares in the future.

The application account is also known as a trust account. This is because it is where the money must be held until the issue of shares. This application trust account ensures that the money cannot be used by the company until the shares are issued.

Date	Details	D	C	Cash at Bank		
28 Aug 2027	Cash at Bank Application Application money received for 39,000, \$1.00 shares	39,000	39,000	D	Desc.	\$
				28 Aug 2027	Application	39,000
				D	Desc.	\$
				28 Aug 2027	Cash at Bank	39,000

Step 2 – Share allotment, application transfer.

On the date of share issue, money is transferred to the share capital account and the application account is closed. This issue is commonly referred to as 'allotment'.

- Debit Application \$39,000 to close this liability account.
- Credit: Ordinary share capital \$39,000 to increase this equity account.

Date	Details	D	C
3 Sep 2027	Application Ordinary share capital Allotment of 39,000, \$1.00 shares	39,000	39,000

Application					
D	Desc.	\$	D	Desc.	\$
3 Sep 2027	Ordinary share capital	39,000	28 Aug 2027	Cash at Bank	39,000

Ordinary share capital					
D	Desc.	\$	D	Desc.	\$
			3 Sep 2027	Application	39,000

Solution Part 2: Share Issue Costs

Step 1 – Share issue cost payment.

The share issue costs are initially paid for with cash at bank.

- Debit Share Issue Costs \$2,800 to increase this expense account.
- Credit Cash at Bank \$2,800 to decrease this asset account.

No further entries are made in the Cash at Bank account regarding the share issue. Therefore, the Cash at Bank account can now be balanced.

Note: the 'Application' entry not bolded in the cash at bank comes is from the previous part of this solution.

Date	Details	D	C
3 Sep 2027	Share Issue Costs Cash at Bank Share issue cost payment	2,800	2,800

Share Issue Costs					
D	Desc.	\$	D	Desc.	\$
3 Sep 2027	Cash at Bank	2,800			

Cash at Bank					
D	Desc.	\$	D	Desc.	\$
28 Aug 2027	Application	39,000	3 Sep 2027	Share Issue Costs	2,800
			30 Jun 2028	Balance c/d	36,200
		39,000			39,000
1 Jul 2028	Balance b/d	36,200			

Step 2 – Transfer of share issue costs.

Capital is subtracted by the share issued costs.

- Debit Ordinary share capital \$2,800 to decrease this equity account.
- Credit Share issue costs \$2,800 to close this expense account.

No further entries are made in the Ordinary Share Capital account regarding the share issue. Therefore, the Ordinary Share Capital account can now be balanced.

Date	Details	D	C
3 Sep 2027	Ordinary share capital Share issue costs Transfer of share issue costs	2,800	2,800

Ordinary share capital					
D	Desc.	\$	D	Desc.	\$
3 Sep 2027	Cash at Bank	2,800	3 Sep 2027	Application	39,000
30 Jun 2028	Balance c/d	36,200			
		39,000			39,000
			1 Jul 2028	Balance b/d	36,200

Share Issue Costs					
D	Desc.	\$	D	Desc.	\$
3 Sep 2027	Cash at Bank	2,800	3 Sep 2027	Ordinary share capital	2,800

Practice Questions

Questions 21-24: Share issue and share issue costs.

Question 21

The following information has been supplied.

- On 19 September 2031, a prospectus was issued by a company for 60,000 ordinary shares at an issue price of \$1.20 per share.
- By 1 October 2031, applications had been received for 58,000 shares.
- On 10 October 2031, shares were allotted by the directors and share issue costs of \$5,500 were paid on the same day.

Required tasks:

a. Prepare the general journal entries to record the issue of shares and share issue costs.

Workings

Values of shares issued =

Date	Details	D	C
	Cash at Bank		
	Application		
	Application money received for 58,000, \$1.20 shares		
	Share Issue Costs		
	Cash at Bank		
	Share issue cost payment		

b. Prepare the general ledger entries to record the issue of shares and share issue costs.

Cash at Bank					
Date	Desc.	\$	Date	Desc.	\$
1 Oct 2031	Application	69,600	10 Oct 2031	Share Issue Costs	5,500

Application					
Date	Desc.	\$	Date	Desc.	\$

Ordinary Share Capital					
Date	Desc.	\$	Date	Desc.	\$

Share Issue Costs					
Date	Desc.	\$	Date	Desc.	\$

c. Calculate the value of Ordinary Share Capital in the equity section of the balance sheet.

Workings

b. Prepare the general ledger entries to record the issue of shares and share issue costs.

Cash at Bank					
Date	Desc.	\$	Date	Desc.	\$

Application					
Date	Desc.	\$	Date	Desc.	\$

Ordinary Share Capital					
Date	Desc.	\$	Date	Desc.	\$

Share Issue Costs					
Date	Desc.	\$	Date	Desc.	\$

c. Calculate the value of Ordinary Share Capital in the equity section of the balance sheet.

Workings:

b. Prepare the general ledger entries to record the issue of shares and share issue costs.

Cash at Bank					
Date	Desc.	\$	Date	Desc.	\$

Application					
Date	Desc.	\$	Date	Desc.	\$

Ordinary Share Capital					
Date	Desc.	\$	Date	Desc.	\$

Share Issue Costs					
Date	Desc.	\$	Date	Desc.	\$

c. Calculate the value of Ordinary Share Capital in the equity section of the balance sheet.

Workings

b. Prepare the general ledger entries to record the issue of shares and share issue costs.

Cash at Bank					
Date	Desc.	\$	Date	Desc.	\$

Application					
Date	Desc.	\$	Date	Desc.	\$

Ordinary Share Capital					
Date	Desc.	\$	Date	Desc.	\$

Share Issue Costs					
Date	Desc.	\$	Date	Desc.	\$

c. Calculate the value of Ordinary Share Capital in the equity section of the balance sheet.

Workings

Retained Earnings and Dividends

Retained Earnings

Retained earnings are the remaining profits after dividends have been paid. Retained earnings is a capital account used to withhold profits for future use. The retained earnings account is also used to distribute profits of the company to shareholders in the form of dividends.

Negative Retained Earnings

It is possible for the retained earnings account to have a negative balance.

	Outline
Causes of negative retained earnings	<p>A negative balance could be caused by one or more of the following:</p> <ul style="list-style-type: none">• A loss in one or more previous years.• The company paying dividends which are greater than the other figures in the retained earnings account. I.e. Dividends paid are higher than profit after tax, transfers from the general reserve to retained earnings or the Retained Earnings opening balance.• The business is using borrowed funds to issue dividends.
Impact of negative retained earnings	<ul style="list-style-type: none">• Insolvency.• Difficulty paying dividends to shareholders.• Less investor interest due to poor performance and less likelihood of future dividends.

Dividends

Dividends are either final dividends or interim dividends. The general journal and general ledger entries record both the approval of the dividend and the payment of the dividend.

Final dividend

- The directors of a company can recommend a final dividend at the end of a financial year. This recommended dividend is discussed at the annual general meeting for shareholder approval before being paid.

Interim dividend

- An interim dividend takes places mid financial year and is declared and paid by directors, without the approval of (being declared by) shareholders. The ability for directors to approve (declare) and pay interim dividends must be outlined in the company's constitution.



National Palace of Pena, Sintra.

Example

A company has supplied the following financial information:

A Company Balance Sheet (extract) As at 30 June 2041	
Equity	\$
Retained Earnings	60,000
Ordinary Share Capital (50,000 shares, issued at \$1.50)	75,000

At 1 July 2041, the business had 50,000 ordinary shares, valued at \$1.50 and a retained earnings balance of \$60,000.

On 18 Nov 2041, an interim dividend of \$0.13 per share was declared by directors.

On 29 Dec 2041, the interim dividend was paid.

On 30 June 2042, the profit after tax for the financial year was \$25,000. Directors recommended that shareholders receive a dividend of \$0.15 per share.

10 September 2042, shareholders approve the dividend payment at the annual general meeting.

28 September 2042, the final dividend is paid.

Required task:

Prepare the general journal and general ledger entries to account for the:

- Interim dividend.
- Profit for the period.
- Final dividend.

Solution: Interim dividend**Step 1 – Interim dividend approved (declared) by the directors.**

The retained earnings opening balance is a credit entry in the general ledger. This is the entry that is not bolded.

The interim dividend payable is a liability from **the date the directors approve (declare) the interim dividend.**

The total interim dividend is found using the following formula:

$$\begin{aligned} \text{Dividend total} &= \text{number of shareholders} \times \text{dividend per share} \\ &= 50,000 \times 0.13 \\ &= 6,500 \end{aligned}$$

The dividends are paid for from the retained earnings account.

- Debit Retained Earnings \$6,500 to decrease this equity account.
- Credit Interim Dividend Payable \$6,500 to increase this liability account.

Date	Details	D	C
18 Nov 2041	Retained Earnings Interim Dividend Payable Dividend approved by the directors.	6,500	6,500

Retained Earnings					
D	Desc.	\$	D	Desc.	\$
18 Nov 2041	Interim Dividend Payable	6,500	1 Jul 2041	Opening Balance	60,000

Interim Dividend Payable					
D	Desc.	\$	D	Desc.	\$
			18 Nov 2041	Retained Earnings	6,500

Step 2 – Payment of interim dividend.

Cash at bank is used to pay the dividend. This closes the interim dividend payable account.

- Debit Interim Dividend Payable \$6,500 to decrease this liability account.
- Credit Cash at Bank \$6,500 to decrease this asset account.

Date	Details	D	C
29 Dec 2041	Interim Dividend Payable Cash at Bank Payment of interim dividend.	6,500	6,500

Interim Dividend Payable					
D	Desc.	\$	D	Desc.	\$
29 Dec 2041	Cash at Bank	6,500	18 Nov 2041	Retained Earnings	6,500

Cash at Bank					
D	Desc.	\$	D	Desc.	\$
			29 Dec 2041	Interim Dividend Payable	6,500

Solution: Profit for the period

Step 1 – Profit to Retained Earnings.

The profit after tax of \$25,000 for the year ended 30 June 2042 is transferred from the profit and loss account to the retained earnings account.

- Debit Profit and Loss \$25,000 to this working account.
- Credit Retained Earnings \$25,000 to increase this equity account.

Note: The profit is calculated in the Profit and Loss account by closing all income and expense accounts to the Profit and Loss Account. The figure of \$25,000 would have been calculated as the amount that the income accounts were greater than the expense accounts. The calculation of the Profit and Loss account was covered in the Year 11 course.

Date	Details	D	C
30 Jun 2042	Profit and Loss Retained Earnings Transfer of profit after tax.	25,000	25,000

Retained Earnings					
D	Desc.	\$	D	Desc.	\$
18 Nov 2041	Interim Dividend Payable	6,500	1 Jul 2041	Opening Balance	60,000
			30 Jun 2042	Profit and Loss	25,000

Profit and Loss					
D	Desc.	\$	D	Desc.	\$
30 Jun 2042	Retained Earnings	25,000			



National Palace of Pena, Sintra.

Solution: Final dividends

Step 1 – Dividend approved by the directors.

The final dividend payable is a liability from **the date the shareholders approve the final dividend.**

The total final dividend is found using the following formula:

$$\begin{aligned} \text{Dividend total} &= \text{number of shareholders} \times \text{dividend per share} \\ &= 50,000 \times 0.15 \\ &= 7,500 \end{aligned}$$

The dividends are paid for from the retained earnings account.

- Debit Retained Earnings \$7,500 to decrease this equity account.
- Credit Final Dividend Payable \$7,500 to increase this liability account.

As this is the last entry in the retained earnings account, it can be balanced off.

Date	Details	D	C
10 Sep 2042	Retained Earnings Final Dividend Payable Dividend approved by the shareholders	7,500	7,500

Retained Earnings					
D	Desc.	\$	D	Desc.	\$
18 Nov 2041	Interim Dividend Payable	6,500	1 Jul 2041	Opening Balance	60,000
10 Sep 2042	Final Dividend Payable	7,500	30 Jun 2042	Profit and Loss	25,000
	Balance c/d	71,000			
		85,000			85,000
				Balance b/d	71,000

Final Dividend Payable					
D	Desc.	\$	D	Desc.	\$
			10 Sep 2042	Retained Earnings	7,500

Step 2 – Payment of dividend.

Cash at bank is used to pay the dividend. This closes the final dividend payable account.

- Debit Final Dividend Payable \$7,500 to decrease this liability account.
- Credit Cash at Bank \$7,500 to decrease this asset account.

The cash at bank account is balanced.

Date	Details	D	C
28 Sep 2042	Final Dividend Payable Cash at Bank Payment of final dividend.	7,500	7,500

Final Dividend Payable					
D	Desc.	\$	D	Desc.	\$
10 Sep 2042	Cash at Bank	7,500	10 Sep 2042	Retained Earnings	7,500

Cash at Bank					
D	Desc.	\$	D	Desc.	\$
			29 Dec 2041	Interim Dividend Payable	6,500
			10 Sep 2042	Final Dividend Payable	7,500

Practice Questions

Questions 25-30: Retained earnings and dividends.

TipsDifference between final and interim dividend process

The main difference between final and interim dividends is the dividend payable account. This will either be 'Interim dividend payable' or 'Final dividend payable' and the descriptions in the general journal. Other than that, the process is largely the same.

Additional share issue

Look out for any issue of shares between the interim and final dividend as this will impact the dividend calculation.

Question 25

Falcon Y Ltd has provided the following financial information:

Falcon Y Ltd Balance Sheet (extract) As at 30 June 2034	
Equity	\$
Retained Earnings	74,000
Ordinary Share Capital (30,000 shares, issued at \$2.85)	85,500

On 30 June 2035, the profit after tax for the financial year was \$47,000. Directors recommended that shareholders receive a dividend of \$0.24 per share.

4 August 2035, shareholders approve the dividend payment at the annual general meeting.

30 August 2035, the final dividend is paid.

Required tasks:

a. Prepare the general journal to account for the dividends and profit.

Final Dividend total =

Date	Details	D	C
30 Jun	Profit and Loss	47,000	
2035	Retained Earnings		47,000
	Transfer of profit after tax.		

b. Prepare the general ledgers to account for the dividends.

Profit and Loss					
Date	Desc.	\$	Date	Desc.	\$
30 Jun 2035	Final Dividend Payable	47,000			

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$
4 Aug 2035	Final Dividend Payable	7,200	1 Jul 2034	Balance b/d	74,000

Cash at Bank					
Date	Desc.	\$	Date	Desc.	\$

Final Dividend Payable					
Date	Desc.	\$	Date	Desc.	\$

Question 26

Maria's Kart Ltd has supplied the following financial information:

Maria's Kart Ltd Balance Sheet (extract) As at 30 June 2041	
Equity	\$
Retained Earnings	55,000
Ordinary Share Capital (200,000 shares, issued at \$0.90)	180,000

On 9 Dec 2041, an interim dividend of \$0.10 per share was declared by directors.

On 14 Dec 2041, the interim dividend was paid.

Required tasks:

a. Prepare the general journal to account for the dividends.

Interim Dividend total =

Date	Details	D	C

b. Prepare the general ledgers to account for the dividends.

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$

Interim Dividend Payable					
Date	Desc.	\$	Date	Desc.	\$

b. Prepare the general ledgers to account for the dividends and profit.

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$

Interim Dividend Payable					
Date	Desc.	\$	Date	Desc.	\$

Cash at Bank					
Date	Desc.	\$	Date	Desc.	\$

Final Dividend Payable					
Date	Desc.	\$	Date	Desc.	\$

b. Prepare the general ledgers to account for the dividends and profit.

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$

Interim Dividend Payable					
Date	Desc.	\$	Date	Desc.	\$

Cash at Bank					
Date	Desc.	\$	Date	Desc.	\$

Final Dividend Payable					
Date	Desc.	\$	Date	Desc.	\$

b. Prepare the general ledgers to account for the dividends and profit.

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$

Loan from Bank					
Date	Desc.	\$	Date	Desc.	\$

Cash at Bank					
Date	Desc.	\$	Date	Desc.	\$

Final Dividend Payable					
Date	Desc.	\$	Date	Desc.	\$

Bonus share issue

A company may choose to issue bonus shares to existing shareholders. The benefit of issuing bonus shares is the ability to compensate shareholders, without a cash outflow taking place. I.e., issuing dividends would be an outflow of cash, whereas when issuing bonus shares no cash outflow takes place. Bonus share issues may take place when an entity is short on cash, but investors still demand regular income. Investors can sell bonus shares for income.

The issue of bonus shares can take place out of retained earnings, general reserve or asset revaluation reserve.

Example

B2 Construction Ltd has provided the following financial information.

B2 Construction Ltd Balance Sheet (extract) As at 30 June 2045	
Equity	\$
General reserve	35,000
Retained Earnings	90,000
Ordinary Share Capital (issued at \$2.00)	160,000

On 5 February 2046, directors of the company have approved an issue of bonus shares to ordinary shareholders of one bonus share for every five shares held. This bonus share issue will use the retained earnings of the company. The bonus shares are issued at \$2.20 fully paid.

Required task:

Prepare the general journal and general ledger entry to record the issue of bonus shares.

Solution: Bonus share issue

Step 1 – Calculation of bonus share issue.

First the number of existing ordinary shares prior to the bonus share issue must be calculated.

Number of existing ordinary shares = total value of existing ordinary shares / share issue price
= 160,000 / 2.00
= 80,000 ordinary shares

The number of bonus shares to issue is found by dividing the existing number of ordinary shares by the bonus share criteria. In this case one bonus share is issued for every five shares held.

Number of bonus shares to issue = Number of existing ordinary shares / Bonus share criteria
= 80,000 / 5
= 16,000 bonus shares

The value of bonus shares is then calculated.

Value of bonus shares issued = Number of bonus shares issued x Share issue value
= 16,000 x 2.20
= 35,200

Therefore, 16,000 bonus shares are issued at \$2.20 per share with a value of \$35,200.

Step 2 – Issue of bonus shares from reserves.

The issue of bonus shares increases ordinary share capital and comes from retained earnings.

- Debit Retained earnings \$35,200 to decrease this equity account.
- Credit Ordinary Share Capital \$35,000 to increase this equity account.

The balance b/d entry in the Ordinary Share Capital ledger account on 1 Jul 2045 is the opening balance from the question.

Date	Details	D	C
5 Feb 2046	Retained Earnings Ordinary share capital Issue of 16,000, \$2.20 bonus shares, from retained earnings.	35,200	35,200

Note: Bonus share issue can come from general reserve, asset revaluation reserve or retained earnings. This would require swapping retained earnings account for either the General Reserve or Asset Revaluation Reserve.

Retained Earnings					
D	Desc.	\$	D	Desc.	\$
5 Feb 2046	Ordinary share capital	35,200	30 Jun 245	Balance	90,000

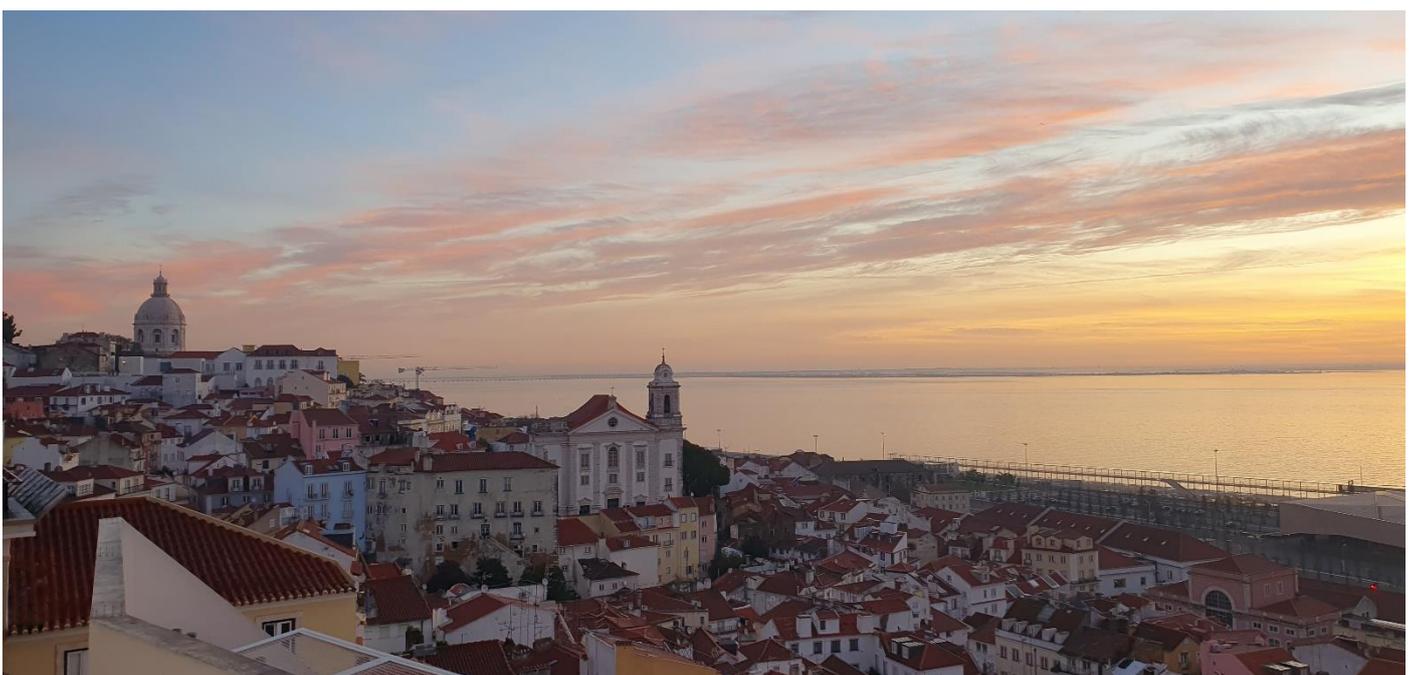
Ordinary Share Capital					
D	Desc.	\$	D	Desc.	\$
			1 Jul 2045	Balance b/d	160,000
			5 Feb 2046	Retained Earnings	35,200

Step 3 – Balance accounts.

Both accounts are balanced at the end of the period. The balance figure is the value these accounts are recorded at in the balance sheet.

Retained Earnings					
D	Desc.	\$	D	Desc.	\$
5 Feb 2046	Ordinary share capital	35,200	30 Jun 245	Balance	90,000
30 Jun 2046	Balance c/d	54,800			
		90,000			90,000
			1 Jul 2046	Balance b/d	54,800

Ordinary Share Capital					
D	Desc.	\$	D	Desc.	\$
30 Jun 2046	Balance c/d	195,200	1 Jul 2045	Balance b/d	160,000
			5 Feb 2046	Retained Earnings	35,200
		195,200			195,200
			1 Jul 2046	Balance b/d	195,200



Miradouro de Santa Luzia, Alfama, Lisbon.

Practice Questions

Questions 31-33: Bonus share issue.

TipsBonus share issue source

The issue of bonus shares can come from retained earnings, general reserve or asset revaluation reserve. This would require swapping retained earnings account for either the General Reserve or Asset Revaluation Reserve.

Question 31

The following financial information has been supplied by Skobie Snacks Ltd.

Skobie Snacks Ltd Balance Sheet (extract) As at 30 June 2038	
Equity	\$
General reserve	40,000
Retained Earnings	60,000
Ordinary Share Capital (issued at \$2.50)	95,000

On 13 April 2039, directors of the company have approved an issue of bonus shares to ordinary shareholders of one bonus share for every ten shares held. This bonus share issue will use the retained earnings of the company. The bonus shares are issued at \$2.50 fully paid.

Required tasks:

a. Prepare the general journal entry to account for the bonus share issue.

Number of existing ordinary shares =

Number of bonus shares to issue =

Value of bonus shares issued =

Date	Details	D	C

b. Prepare the general ledgers to account for the bonus share issue.

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$
13 Apr 2039	Ordinary Share Capital	9,500	1 Jul 2038	Balance b/d	60,000

Ordinary Share Capital					
Date	Desc.	\$	Date	Desc.	\$

Question 32

The following financial information has been supplied by Space Yeet Ltd.

Space Yeet Ltd Balance Sheet (extract) As at 30 June 2052	
Equity	\$
General reserve	90,000
Retained Earnings	40,000
Ordinary Share Capital (issued at \$2.90)	142,100

On 15 Dec 2052, directors of the company have approved an issue of bonus shares to ordinary shareholders of one bonus share for every five shares held. This bonus share issue will come from the general reserve of the company. The bonus shares are issued at \$3.20 fully paid.

Required tasks:

a. Prepare the general journal entry to account for the bonus share issue.

Workings

Date	Details	D	C

b. Prepare the general ledgers to account for the bonus share issue.

General Reserve					
Date	Desc.	\$	Date	Desc.	\$

Ordinary Share Capital					
Date	Desc.	\$	Date	Desc.	\$

Question 33

Save the Planet Ltd has provided the following information.

Save the Planet Ltd Balance Sheet (extract) As at 30 June 2061	
Equity	\$
General reserve	40,000
Retained Earnings	60,000
Ordinary Share Capital (issued at \$1.80)	108,000
Asset Revaluation Reserve	30,000

On 5 Jan 2062, directors of the company have approved an issue of bonus shares to ordinary shareholders of one bonus share for every five shares held. This bonus share issue will come from the asset revaluation reserve of the company. The bonus shares are issued at \$1.85 fully paid.

Required tasks:

a. Prepare the general journal entry to account for the bonus share issue.

Workings

Date	Details	D	C

b. Prepare the general ledgers to account for the bonus share issue.

Asset Revaluation Reserve					
Date	Desc.	\$	Date	Desc.	\$

Ordinary Share Capital					
Date	Desc.	\$	Date	Desc.	\$

General Reserve and Retained Earnings

A general reserve is created by a company to set aside funds for future use. Funds can be transferred to or from the general reserve from retained earnings.

Example – Transfer to the general reserve

Palm Springs Hammocks Ltd has provided the following information.

Palm Springs Hammocks Ltd Balance Sheet (extract) As at 1 July 2038	
Equity	\$
Retained Earnings	65,000
General Reserve	10,000
Ordinary Share Capital (50,000 shares issued at \$3.00)	150,000

On 30 June 2039:

- Profit for the year was \$40,000.
- The directors decide to increase the general reserve to \$25,000 from retained earnings.

Required task:

Prepare the general ledger and retained earnings ledger account as at 30 June 2039.

Solution

Step 1 – Transfer to General Reserve from Retained Earnings.

The retained earnings account is credited with opening balance and profit.

The increase in general reserve = Desired balance – opening balance
 = 25,000 – 10,000
 = 15,000

To move funds from the retained earnings to general reserve:

- Debit Retained Earnings \$15,000 to decrease this equity account.
- Credit General Reserve \$15,000 to increase this equity account.

Date	Details	D	C
30 Jun 2039	Retained Earnings	15,000	
	General Reserve		15,000
	Transfer to general reserve		

Retained Earnings					
D	Desc.	\$	D	Desc.	\$
30 Jun 2039	General Reserve	15,000	1 Jul 2038	Balance b/d	65,000
			30 Jun 2039	Profit and Loss	40,000

General Reserve					
D	Desc.	\$	D	Desc.	\$
			1 Jul 2038	Balance b/d	10,000
			30 Jun 2039	Retained Earnings	15,000

Step 2 – Balance Accounts.

The retained earnings and general reserve ledger account are balanced.

Retained Earnings					
D	Desc.	\$	D	Desc.	\$
30 Jun 2039	General Reserve	15,000	1 Jul 2038	Balance b/d	65,000
30 Jun 2039	Balance c/d	90,000	30 Jun 2039	Profit and Loss	40,000
		105,000			105,000
			1 Jul 2039	Balance b/d	90,000

General Reserve					
D	Desc.	\$	D	Desc.	\$
30 Jun 2039	Balance c/d	25,000	1 Jul 2038	Balance b/d	10,000
			30 Jun 2039	Retained Earnings	15,000
		25,000			25,000
			1 Jul 2039	Balance b/d	25,000

Example – Transfer from the general reserve

A company has provided the following information.

Palm Springs Hammocks Ltd Balance Sheet (extract) As at 1 July 2042	
Equity	\$
Retained Earnings	50,000
General Reserve	70,000
Ordinary Share Capital (50,000 shares issued at \$3.00)	150,000

On 30 June 2043:

- Profit for the year was \$15,000.
- The directors decide to transfer \$30,000 from the general reserve to retained earnings.

Required task:

Prepare the general ledger and retained earnings ledger account as at 30 June 2043.

Solution

Step 1 – Transfer from General Reserve to Retained Earnings.

The retained earnings account is credited with opening balance and profit. To move funds from the retained earnings to general reserve:

- Credit Retained Earnings \$30,000 to increase this equity account.
- Debit General Reserve \$30,000 to decrease this equity account.

Date	Details	D	C
30 Jun 2043	General Reserve	30,000	
	Retained Earnings		30,000
	Transfer to retained earnings		

Retained Earnings					
D	Desc.	\$	D	Desc.	\$
			1 Jul 2042	Balance b/d	50,000
			30 Jun 2043	Profit and Loss	15,000
			30 Jun 2043	General Reserve	30,000

General Reserve					
D	Desc.	\$	D	Desc.	\$
30 Jun 2043	Retained Earnings	30,000	1 July 2042	Balance b/d	70,000

Step 2 – Balance Accounts.

The retained earnings and general reserve account are balanced.

Retained Earnings					
D	Desc.	\$	D	Desc.	\$
30 Jun 2043	Balance c/d	95,000	1 Jul 2042	Balance b/d	50,000
			30 Jun 2043	Profit and Loss	15,000
			30 Jun 2043	General Reserve	30,000
		95,000			95,000
			1 Jul 2043	Balance b/d	95,000

General Reserve					
D	Desc.	\$	D	Desc.	\$
30 Jun 2043	Retained Earnings	30,000	1 Jul 2042	Balance b/d	70,000
	Balance c/d	40,000			
		70,000			70,000
			1 Jul 2043	Balance b/d	40,000

Practice Questions

Questions 34-37: General Reserve and Retained Earnings.

Question 34

The following information has been provided by Zelda's Linking Service Ltd.

Zelda's Linking Service Ltd Balance Sheet (extract) As at 1 July 2039	
Equity	\$
Retained Earnings	78,000
General Reserve	23,000
Ordinary Share Capital (40,000 shares issued at \$2.50)	100,000

On 30 June 2039

- Profit for the year was \$36,000.
- The directors decide to increase the general reserve to \$40,000.

Required tasks:

a. Prepare the general journal to account for the transfer.

The increase in general reserve =

Date	Details	D	C
	Retained Earnings		
	General Reserve		
	Transfer to general reserve		

b. Prepare the general ledgers to account for the transfer and profit and loss.

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$

General Reserve					
Date	Desc.	\$	Date	Desc.	\$

Question 35

The following information has been provided by Six Four Tendo Ltd.

Six Four Tendo Ltd Balance Sheet (extract) As at 1 July 2033	
Equity	\$
Retained Earnings	53,000
General Reserve	41,000

On 30 June 2034

- Profit for the year was \$12,000.
- The directors decide to transfer \$20,000 from the general reserve to retained earnings.

Required tasks:

a. Prepare the general journal to account for the transfer.

Date	Details	D	C

b. Prepare the general ledgers to account for the transfer and profit and loss.

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$

General Reserve					
Date	Desc.	\$	Date	Desc.	\$

Question 36

Crypto Farm Ltd has provided the following information.

Crypto Farm Ltd Balance Sheet (extract) As at 1 July 2050	
Equity	\$
Retained Earnings	29,000

On 30 June 2051:

- Profit for the year was \$36,000.
- The directors decide to create a general reserve worth \$18,000.

Required tasks:

a. Prepare the general journal to account for the transfer.

Date	Details	D	C

b. Prepare the general ledgers to account for the transfer and profit and loss.

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$

General Reserve					
Date	Desc.	\$	Date	Desc.	\$

Question 37

Doge Dollar Ltd has supplied the following financial information.

Doge Dollar Ltd Balance Sheet (extract) As at 1 July 2048	
Equity	\$
Retained Earnings	95,000
General Reserve	78,000

On 30 June 2049:

- Profit for the year was \$21,000.
- The directors decide to transfer \$40,000 from the general reserve to retained earnings.

Required tasks:

a. Prepare the general journal to account for the transfer.

Date	Details	D	C

b. Prepare the general ledgers to account for the transfer and profit and loss.

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$

General Reserve					
Date	Desc.	\$	Date	Desc.	\$

Asset Revaluation Reserve

An asset revaluation is created when the value of a non-current asset increases above the historical cost of the asset recorded on the balance sheet. For example, the value of land purchased for \$250,000 five years ago is revalued today at \$300,000. For the accounting records to accurately portray the financial position of the company, the asset must be revalued at an increased price. This is done through the asset revaluation reserve.

Example

B12 Constructions has provided the following financial information.

On 15 May 2025, land was purchased for \$180,000.

On 30 June 2031, the directors have determined that land should be recorded at market value of \$260,000.

Required task:

Prepare the general journal and general ledger entries to revalue the land.

Solution

Step 1 – Revaluation of land.

The opening balance is present in the land account as the balance brought down from the time of purchase.

The change in valuation is found using the following formula.

$$\begin{aligned} \text{Change in valuation} &= \text{New valuation} - \text{Opening balance} \\ &= 260,000 - 180,000 \\ &= 80,000 \end{aligned}$$

The change in valuation is recorded in the land account and asset revaluation reserve account.

- Debit Land \$80,000 to increase this asset account.
- Credit Revaluation Reserve \$80,000 to increase this equity account.

Date	Details	D	C
30 Jun 2043	Land	80,000	
	Asset Revaluation Reserve		80,000
	Revaluation of Land		

Land					
D	Desc.	\$	D	Desc.	\$
1 July 2031	Balance b/d	180,000			
30 Jun 2031	Asset Revaluation Reserve	80,000			

Asset Revaluation Reserve					
D	Desc.	\$	D	Desc.	\$
			30 Jun 2031	Land	80,000

Step 2 – Balance accounts.

The land account is balanced. The balance figure is the value land is recorded at in the balance sheet.

Land					
D	Desc.	\$	D	Desc.	\$
1 July 2031	Balance b/d	180,000	30 Jun 2031	Balance c/d	260,000
30 Jun 2031	Revaluation Reserve	80,000			
		260,000			260,000
1 Jul 2031	Balance b/d	260,000			

Practice Questions

Questions 38-39: Asset Revaluation Reserve.

Question 38

A company has provided the following financial information.

On 28 March 2036, land was purchased for \$150,000.

On 30 June 2042, the directors have determined that land should be recorded at market value of \$190,000.

Required tasks:

a. Prepare the general journal entry to account for the asset revaluation.

Change in valuation =

Date	Details	D	C

b. Prepare the general ledger to account for the asset revaluation.

Land					
Date	Desc.	\$	Date	Desc.	\$

Asset Revaluation Reserve					
Date	Desc.	\$	Date	Desc.	\$

Question 39

A business has provided the following financial information.

On 1 Feb 2042, land was purchased for \$320,000.

On 8 October 2048, the directors revalued land to reflect an increase in the market value to \$480,000.

On 30 March 2051, the directors have determined that land should be recorded at market value of \$650,000.

Required tasks:

a. Prepare the general journal entry to account for the asset revaluation during the year ended 30 June 2051.

Workings

Date	Details	D	C

b. Prepare the general ledger to account for the asset revaluation during the year ended 30 June 2051.

Hint: The opening balance of the asset revaluation reserve account must be calculated.

Workings

Land					
Date	Desc.	\$	Date	Desc.	\$

Asset Revaluation Reserve					
Date	Desc.	\$	Date	Desc.	\$

Statement of Changes in Equity

The statement of changes in equity records changes in the equity section of a Statement of Financial Position (balance sheet) during a reporting period and is included in the annual report. There are two common formats for the SCE, horizontal and vertical. The first solution to the example demonstrates the horizontal format and the second solution demonstrates the vertical format.

Example

Margaret River Free Range Ltd has provided the following financial information for the year ended 30 June 2029.

Margaret River Free Range Ltd Trial Balance (extract) as at 1 July 2028	
	\$
Cash at bank	80,000
Retained earnings	110,000
Ordinary share capital (100,000 ordinary shares issued at \$1.20 each)	120,000
General reserve	55,000

Additional information:

- On 2 August 2028, shareholders approved the final dividend of \$0.10 per share at the AGM.
- On 1 September 2028, 40,000 ordinary shares were offered to the public for a price of \$1.50 each. The share issue closed fully subscribed on 21 September 2028. Shares were issued 28 September 2028. Share issue costs of \$2,500 were paid on 21 September 2021. The company's policy is to close share issue costs on the same date as allotment.
- On 1 February 2029 the entity issued one bonus share for every ten shares currently held. The issue price was \$1.50 fully paid and was made from the general reserve account.
- \$25,000 is to be transferred from retained earnings the general reserve account.
- On 30 June 2029, a final dividend was proposed by directors of \$0.18 per share. The company's annual general meeting will take place on 31 August 2029.
- Profit after tax for the period was \$75,000.
- Land was purchased five years ago for \$150,000. The directors have determined that the market value of land of \$183,000 is to be recorded.

Required task:

Prepare a Statement of Changes in Equity for the year ended 30 June 2029.

Solution

Step 1 – Setup of initial layout of the SCE.

The horizontal format of the SCE has the following headings for each column and row. During each step a new column will be completed from left to right.

Margaret River Free Range Ltd Statement of Changes in Equity For the year ended 30 June 2029					
	Ordinary share capital	Retained earnings	Asset revaluation reserve	General reserve	Total equity
Balance at beginning					
Issue of share capital					
Share issue costs					
Issue of bonus shares					
Dividends					
Total comprehensive income for the period					
Transfer to/from reserves					
Balance as at 30 June 2029					

Step 2 – Ordinary share capital column preparation.

Ordinary Share capital balance at beginning

The balance at beginning of Ordinary Share Capital was given in the question as **\$120,000**.

The issue of share capital is found using the below formula.

Issue of share capital = Number of shares issued x Share price

= 40,000 x 1.50

= **\$60,000**

Share issue costs.

The share issue costs were given in the question as **(\$2,500)**. This number is in brackets as it represents a decrease in equity rather than an increase.

Issue of bonus shares.

Number of ordinary shares at start of period = value of share capital at start of period / share issue price

= 120,000 / 1.20

= 100,000 ordinary shares

Share capital at time of bonus issue = Starting ordinary shares + additional shares issued

= 100,000 + 40,000

= 140,000 ordinary shares

Value of bonus shares issued = (Share capital / bonus share criteria) x value of shares

= (140,000 / 10 per share) x 1.50

= 14,000 x 1.50

= **\$21,000**

This issue of bonus shares was paid for with funds from the general reserve. A corresponding entry of **(\$21,000)** is entered in the general reserve column.

The figures calculated are entered into the SCE Ordinary share capital column and the balance at the end of the period is calculated.

Margaret River Free Range Ltd					
Statement of Changes in Equity					
For the year ended 30 June 2029					
	Ordinary share capital	Retained earnings	Asset revaluation reserve	General reserve	Total equity
Balance at beginning	120,000				
Issue of share capital	60,000				
Share issue costs	(2,500)				
Issue of bonus shares	21,000			(21,000)	
Dividends					
Total comprehensive income for the period					
Transfer to reserves					
Balance as at 30 June 2029	198,500				

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Step 3 – Retained earnings column preparation.

Retained earnings balance at beginning.

The balance at beginning was given in the question as **\$110,000**.

Transfer to general reserve account.

\$25,000 is to be transferred from retained earnings the general reserve account.

- A decrease is entered in the retained earnings account of (\$25,000).
- A corresponding entry of \$25,000 is made in the general reserve column to reflect the increase.

Dividends.

Note: Only the dividends paid during a period are recorded in SCE. I.e., the SCE will include interim dividends from this financial year (if paid during this financial year) plus the final dividend from the previous period. Final dividends are approved by shareholders at an AGM which takes place in the following financial period.

The question stated, "On 2 August 2028, shareholders approved the final dividend of \$0.10 per share at the AGM."

The value of dividends paid during this financial year is the number of ordinary share capital at the start of period multiplied by the value of the final dividend.

$$\begin{aligned}\text{Dividends} &= \text{Opening ordinary share capital} \times \text{final dividend per share} \\ &= 100,000 \times 0.10 \\ &= 10,000\end{aligned}$$

Therefore, the value of dividends paid during the year ended 30 June 2029 is \$10,000. The final dividend paid is in brackets in the SCE as it is a negative figure that reduces retained earnings.

The final dividend for the year ended 30 June 2029 will be relevant for the SCE for the year ended 30 June 2030. This is because this will not be approved by shareholders until the AGM which takes place after balance date. The calculation of this final dividend is demonstrated below as a reference.

On 30 June 2029, a final dividend was proposed by directors of \$0.18 per share. The company's annual general meeting will take place on 31 August 2029.

$$\begin{aligned}\text{Final dividend for 2028} &= \text{number of shares at end of previous financial year} \times \text{dividend value} \\ &= (\text{Opening share capital} + \text{Number of shares issued on 1 Sept} + \text{Bonus shares issued}) \times \text{Dividend value} \\ &= (100,000 + 40,000 + 14,000) \times 0.18 \\ &= 27,720\end{aligned}$$

Therefore, in the next year's SCE the value of final dividends included in the dividends figure will be \$27,720.

Total comprehensive income for the period.

The total comprehensive income for the period is the profit after tax figure provided in the question of **\$75,000**.

The figures calculated are entered into the SCE Retained earnings column and the balance at the end of the period is calculated.

Margaret River Free Range Ltd					
Statement of Changes in Equity					
For the year ended 30 June 2029					
	Ordinary share capital	Retained earnings	Asset revaluation reserve	General reserve	Total equity
Balance at beginning	120,000	110,000			
Issue of share capital	60,000				
Share issue costs	(2,500)				
Issue of bonus shares	21,000			(21,000)	
Dividends		(10,000)			
Total comprehensive income for the period		75,000			
Transfer to reserves		(25,000)		25,000	
Balance as at 30 June 2029	198,500	150,000			

Step 4 – Asset revaluation reserve column preparation.

Balance at beginning.

There was no opening balance of the asset revaluation reserve listed during the question. Therefore, the balance at beginning is **\$0**.

Total comprehensive income.

Land revaluation = new valuation – previous valuation

= 183,000 – 150,000

= **\$33,000**

The figures calculated are entered into the SCE Asset revaluation reserve column and the balance at the end of the period is calculated.

Margaret River Free Range Ltd					
Statement of Changes in Equity					
For the year ended 30 June 2029					
	Ordinary share capital	Retained earnings	Asset revaluation reserve	General reserve	Total equity
Balance at beginning	120,000	110,000	0		
Issue of share capital	60,000				
Share issue costs	(2,500)				
Issue of bonus shares	21,000			(21,000)	
Dividends		(10,000)			
Total comprehensive income for the period		75,000	33,000		
Transfer to reserves		(25,000)		25,000	
Balance as at 30 June 2029	198,500	150,000	33,000		

Step 5 – General reserve column.

Balance at beginning

The balance at beginning was given in the question as **\$55,000**.

Issue of bonus shares and transfer to reserves

These values were entered in this column during previous steps at the same time of the entry in the corresponding columns.

The figures calculated are entered into the SCE General reserve column and the balance at the end of the period is calculated.

Margaret River Free Range Ltd					
Statement of Changes in Equity					
For the year ended 30 June 2029					
	Ordinary share capital	Retained earnings	Asset revaluation reserve	General reserve	Total equity
Balance at beginning	120,000	110,000	0	55,000	
Issue of share capital	60,000				
Share issue costs	(2,500)				
Issue of bonus shares	21,000			(21,000)	
Dividends		(10,000)			
Total comprehensive income for the period		75,000	33,000		
Transfer to reserves		(25,000)		25,000	
Balance as at 30 June 2029	198,500	150,000	33,000	59,000	

Step 6 – Total equity.

The values in the total equity column are calculated by adding together the values in each row.

Margaret River Free Range Ltd					
Statement of Changes in Equity					
For the year ended 30 June 2029					
	Ordinary share capital	Retained earnings	Asset revaluation reserve	General reserve	Total equity
Balance at beginning	120,000	110,000	0	55,000	285,000
Issue of share capital	60,000				60,000
Share issue costs	(2,500)				(2,500)
Issue of bonus shares	21,000			(21,000)	0
Dividends		(10,000)			(10,000)
Total comprehensive income for the period		75,000	33,000		108,000
Transfer to reserves		(25,000)		25,000	0
Balance as at 30 June 2029	198,500	150,000	33,000	59,000	440,500



Paris rooftop, Paris.

Solution 2 – Vertical SCE Layout

Step 1 – Top section preparation.

The top of the SCE lists the company name, name of the statement and 'for the year ended 30 June 20XX'.

Profit for the period

The profit for the period is the profit after tax figure provided in the question of **\$75,000**.

Changes in Revaluation reserve during period

Land revaluation = new valuation – previous valuation

= 183,000 – 150,000

= **\$33,000**

Company Name Statement of Changes in Equity For the year ended 30 June 2029	
Profit for the period	75,000
Changes in Revaluation reserve during period	33,000
Total recognised income and expenses for the period	108,000

Step 2 – Ordinary share capital section preparation.

Ordinary share capital balance at the start of period

The balance at beginning was given in the question as **\$120,000**.

The issue of share capital is found using the below formula.

Issue of share capital = Number of shares issued x Share price

= 40,000 x 1.50

= **\$60,000**

Share issue costs.

The share issue costs were given in the question as **(\$2,500)**.

Bonus share issue.

Number of ordinary shares at start of period = value of share capital at start of period / share issue price

= 120,000 / 1.20

= 100,000 ordinary shares

Share capital at time of bonus issue = Starting ordinary shares + additional shares issued

= 100,000 + 40,000

= 140,000 ordinary shares

Value of bonus shares issued = (Share capital / bonus share criteria) x value of shares

= (140,000 / 10 per share) x 1.50

= 14,000 x 1.50

= **\$21,000**

This issue of bonus shares was paid for with funds from the general reserve. A corresponding entry of **(\$21,000)** will be entered in a later section.

The figures calculated are entered into the SCE Ordinary share capital section and the balance at the end of the period is calculated.

Ordinary share capital	
Balance at start of period	120,000
Issue of share capital	60,000
Share issue costs	(2,500)
Bonus share issue	21,000
Total share capital	198,500

Step 3 – Reserves section preparation.

Asset revaluation reserve balance at start of the period.

There was no opening balance of the asset revaluation reserve listed during the question. Therefore, the balance at beginning is **\$0**.

Gain on revaluation.

Land revaluation = new valuation – previous valuation
= 183,000 – 150,000
= \$33,000

The figures calculated are entered into the SCE Asset revaluation reserve section and the balance at the end of the period is calculated.

General reserve balance at start of the period.

The balance at beginning was given in the question as **\$55,000**.

Bonus share issue.

These values were entered in this column simultaneously at the same time of the entry in the corresponding columns.

The figures calculated are entered into the SCE General reserve section and the balance at the end of the period is calculated.

The Total Reserves is calculated by adding together the balance at end of period for the asset revaluation reserve and the general reserve.

Reserves	
Asset revaluation reserve	
Balance at start of the period	0
Gain on revaluation	33,000
Balance at end of period	33,000
General reserve	
Balance at start of period	55,000
Bonus share issue	(21,000)
Transfer to/from retained earnings	25,000
Balance at end of period	59,000
Total Reserves	92,000

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Step 4 – Retained earnings section preparation.

Balance at beginning.

The balance at beginning was given in the question as **\$110,000**.

Profit for the period.

The total comprehensive income for the period is the profit after tax figure provided in the question of **\$75,000**.

Retained earnings total for the period.

Total for the period = Balance at beginning + Profit for the period
= **\$185,000**

Transfer to general reserve account.

\$25,000 is to be transferred from retained earnings to the general reserve account. A decrease is entered in the retained earnings account of (\$25,000).

Dividends.

Dividends.

Note: Only the dividends paid during a period are recorded in SCE. I.e., the SCE will include interim dividends from this financial year (if paid during this financial year) plus the final dividend from the previous period. Final dividends are approved by shareholders at an AGM which takes place in the following financial period.

The question stated, "On 2 August 2028, shareholders approved the final dividend of \$0.10 per share at the AGM."

The value of dividends paid during this financial year is the number of ordinary share capital at the start of period multiplied by the value of the final dividend.

Dividends = Opening ordinary share capital x final dividend per share
= 100,000 x 0.10
= 10,000

Therefore, the value of dividends paid during the year ended 30 June 2029 is \$10,000. The final dividend paid is in brackets in the SCE as it is a negative figure that reduces retained earnings.

The final dividend for the year ended 30 June 2029 will be relevant for the SCE for the year ended 30 June 2030. This is because this will not be approved by shareholders until the AGM which takes place after balance date. The calculation of this final dividend is demonstrated below as a reference.

On 30 June 2029, a final dividend was proposed by directors of \$0.18 per share. The company's annual general meeting will take place on 31 August 2029.

Final dividend for 2028 = number of shares at end of previous financial year x dividend value
= (Opening share capital + Number of shares issued on 1 Sept + Bonus shares issued) x Dividend value
= (100,000 + 40,000 + 14,000) x 0.18
= 27,720

Therefore, in next year's SCE the value of final dividends included in the dividends figure will be \$27,720.

Balance at end of the period.

Balance at end of the period = Total for the period + Transfer to the general reserve + Dividends
= 185,000 + (-25,000) + (-27,720)
= 132,280

The figures calculated are entered into the SCE Retained earnings section.

Retained earnings	
Balance at start of period	110,000
Profit for the period	75,000
Total for the period	185,000
Transfer to general reserve	(25,000)
Dividends	(10,000)
Balance at end of the period	150,000

Step 4 – All prepared sections combined.

The Statement of Changes in Equity is now finalized as demonstrated below.

Company Name Statement of Changes in Equity For the year ended 30 June 2029	
Profit for the period	75,000
Changes in Revaluation reserve during period	33,000
Total recognised income and expenses for the period	108,000
Ordinary share capital	
Balance at start of period	120,000
Issue of share capital	60,000
Share issue costs	(2,500)
Bonus share issue	21,000
Total share capital	198,500
Reserves	
Asset revaluation reserve	
Balance at start of the period	0
Gain on revaluation	33,000
Balance at end of period	33,000
General reserve	
Balance at start of period	55,000
Bonus share issue	(21,000)
Transfer to/from retained earnings	25,000
Balance at end of period	59,000
Total Reserves	92,000
Retained earnings	
Balance at start of period	110,000
Profit for the period	75,000
Total for the period	185,000
Transfer to general reserve	(25,000)
Dividends	(10,000)
Balance at end of the period	150,000

Practice Questions

Questions 40-43: Statement of Changes in Equity.

Tips	<u>General Reserve and Retained Earnings transfer</u> The transfer to/from reserves will either be positive or negative whether it is 'to' OR 'from'.
	<u>Layout examples and choice</u> On the following page is example horizontal and vertical, these are useful to refer to during initial practice. You can choose to complete either the horizontal or vertical statement layout based on personal preference.

Statement of Changes in Equity – Statement Preparation

A summary of both statement layouts is provided below for reference.

Key	<ul style="list-style-type: none"> • Green = positive figure. • Red = negative figure. • Blue = no net change in equity.
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Company Name Statement of Changes in Equity For the year ended 30 June 20XX					
	Ordinary share capital	Retained earnings	Asset revaluation reserve	General reserve	Total equity
Balance at beginning	X	X	X	X	\$TOTAL
Issue of share capital	X				X
Share issue costs	(X)				(X)
Issue of bonus shares	X	(X)	(X)	(X)	0
Dividends		(X)			(X)
Total comprehensive income for the period		X	X		X
Transfer to OR from reserves		X Or (X)		(X) or X	0
Balance as at 30 June 20XX	\$TOTAL	\$TOTAL	\$TOTAL	\$TOTAL	\$TOTAL

Company Name Statement of Changes in Equity For the year ended 30 June 20XX	
Profit for the period	X
Changes in Revaluation reserve during period	X
Total recognised income and expenses for the period	\$TOTAL
Ordinary share capital	
Balance at start of period	Opening Balance
Issue of share capital	X
Share issue costs	(X)
Bonus share issue	X
Total share capital	\$TOTAL
Reserves	
Asset revaluation reserve	
Balance at start of the period	Opening Balance
Gain on revaluation	X
Balance at end of period	Closing Balance
General reserve	
Balance at start of period	Opening Balance
Bonus share issue	(X)
Transfer to OR from retained earnings	Positive figure if to reserve OR Negative figure if from reserve
Balance at end of period	Closing Balance
Total Reserves	General reserve + Asset Revaluation Reserve
Retained earnings	
Balance at start of period	Opening Balance
Profit for the period	X
Total for the period	\$TOTAL of above two entries
Transfer to OR from general reserve	Negative figure if to reserve OR Positive figure if from reserve
Dividends	(X)
Bonus share issue	(X)
Balance at end of the period	Previous \$TOTAL + above two entries

Question 40

The following information has been provided by Tech Wire Frontier Ltd on 1 July 2051.

Tech Wire Frontier Ltd Trial Balance (extract) as at 1 July 2051	
	\$
Cash at bank	40,000
Retained earnings	96,000
Ordinary share capital (Issued at \$2.50 each)	160,000
Asset Revaluation Reserve	24,000
General reserve	67,000

Additional information:

- On 2 September 2051, shareholders approved the final dividend of \$0.12 per share at the AGM.
- On 1 October 2051, 70,000 ordinary shares were offered to the public for a price of \$2.45 each. The share issue closed fully subscribed on 27 October 2051. Shares were issued 30 September 2051. Share issue costs of \$4,800 were paid on 27 October 2051. The company's policy is to close share issue costs on the same date as allotment.
- On 1 January 2052 the entity issued one bonus share for every ten shares currently held. The issue price was \$2.45 fully paid and was made from the retained earnings account.
- \$18,000 is to be transferred to retained earnings from the general reserve account.
- On 30 June 2052, a final dividend was proposed by directors of \$0.13 per share. The company's annual general meeting will take place on 30 September 2052.
- Profit after tax for the period was \$93,000.
- The directors have determined that the market value of land of should be revalued with an increase of \$34,000.

Required task:

Prepare a Statement of Changes in Equity for the year ended 30 June 2052.

Workings

Horizontal SCE method

Tech Wire Frontier Ltd					
Statement of Changes in Equity					
For the year ended 30 June 2052					
	Ordinary share capital	Retained earnings	Asset revaluation reserve	General reserve	Total equity
Balance at beginning					
Issue of share capital					
Share issue costs					
Issue of bonus shares					
Dividends					
Total comprehensive income for the period					
Transfer to reserves					
Balance as at 30 June 2052					

Tech Wire Frontier Ltd Statement of Changes in Equity For the year ended 30 June 2052	
Profit for the period	
Changes in Revaluation reserve during period	
Total recognised income and expenses for the period	
Ordinary share capital	
Balance at start of period	
Issue of share capital	
Share issue costs	
Bonus share issue	
Total share capital	
Reserves	
Asset revaluation reserve	
Balance at start of the period	
Gain on revaluation	
Balance at end of period	
General reserve	
Balance at start of period	
Transfer to retained earnings	
Balance at end of period	
Total Reserves	
Retained earnings	
Balance at start of period	
Profit for the period	
Total for the period	
Transfer from general reserve	
Dividends	
Bonus share issue	
Balance at end of the period	

Question 41

The following information has been provided by Dolphin Rides Ltd on 1 July 2043.

Dolphin Rides Ltd Balance Sheet (extract) as at 1 July 2043	
	\$
Retained earnings	90,000
Ordinary share capital (3.50 each)	70,000
General reserve	45,000

Additional information

- On 28 February 2044 the directors decided to revalue land upward by \$58,000 and increased the general reserve to \$53,000.
- On 19 April 2044, the directors issued bonus shares to ordinary shareholders of one bonus share for every five shares held, using the retained earnings of the company. The bonus shares are issued at \$3.90 each.
- Profit after tax for the year ended 30 June 2044 was \$65,400.

Required task:

Prepare a Statement of Changes in Equity for the year ended 30 June 2044.

Workings

Horizontal SCE method

Dolphin Rides Ltd Statement of Changes in Equity For the year ended 30 June 2044					
	Ordinary share capital	Retained earnings	Asset revaluation reserve	General reserve	Total equity

Dolphin Rides Ltd Statement of Changes in Equity For the year ended 30 June 2044	
Ordinary share capital	
Reserves	
Asset revaluation reserve	
General reserve	
Retained earnings	

Question 42

The following information has been provided by Bean Bag Empire Ltd on 1 July 2027.

Bean Bag Empire Ltd Trial Balance (extract) as at 1 July 2027	
	\$
Cash at bank	75,000
Retained earnings	130,000
Ordinary share capital (3.90 each)	97,500
General reserve	80,000

Additional information:

- On 1 December 2027, 50,000 ordinary shares were offered to the public for a price of \$4.00 each. The share issue closed fully subscribed on 5 January 2028. Shares were issued 10 January 2028. Share issue costs of \$6,500 were paid on 5 January 2028. The company's policy is to close share issue costs on the same date as allotment.
- On 1 January 2027, the directors approved an interim dividend of \$0.15 per share.
- On 1 March 2028 the entity issued one bonus share for every ten shares currently held. The issue price was \$4.00 fully paid and was made from the retained earnings account.
- \$20,000 is to be transferred from the general to retained earnings.
- On 30 June 2028, a final dividend was proposed by directors of \$0.20 per share. The company's annual general meeting will take place on 31 August 2028.
- Profit after tax for the period was \$81,000.
- At the start of the period land was valued at \$280,000. The directors have determined that the market value of land should be revalued to \$320,000.

Required task:

Prepare a Statement of Changes in Equity for the year ended 30 June 2028.

Workings

Question 43

The following information has been provided by Big Splash Ltd on 1 July 2037.

Dolphin Rides Ltd	
Balance Sheet (extract)	
as at 1 July 2036	
	\$
Retained earnings	85,000
Ordinary share capital (\$3.00 each)	90,000
General reserve	60,000
Asset revaluation reserve	41,000

Additional information:

- On 14 September 2035, shareholders approved the final dividend of \$0.08 per share at the AGM.
- On 14 March 2037 the directors decided to revalue land upward by \$28,000 and increased the general reserve to \$70,000.
- On 19 May 2037, the directors issued bonus shares to ordinary shareholders of one bonus share for every ten shares held, using the general reserve of the company. The bonus shares are issued at \$3.10 each.
- On 1 April 2037, directors approved an interim dividend of \$0.07 per share.
- On 30 June 2037, a final dividend was proposed by directors of \$0.12 per share. The company's annual general meeting will take place on 31 August 2028.
- Profit after tax for the year ended 30 June 2037 was \$48,900.

Required task:

Prepare a Statement of Changes in Equity for the year ended 30 June 2037.

Workings

Statement of Comprehensive Income

The Statement of Comprehensive Income portrays the profit or loss of a company.

Example

Visco Girl Ltd has provided the following information.

Visco Girl Ltd Trial balance (extract) As at 30 June 2029		
	Debit \$	Credit \$
Cost of sales	46,000	
Sales		120,000
Interest expense	2,500	
Accounts receivable	6,000	
Accounts payable		3,000
Discount received		2,100
Cartage inwards	400	
Dividends received		7,000
Sales returns	2,000	
Machinery	25,000	
Accumulated Depreciation of machinery		9,000
Depreciation of machinery	6,000	
Loan interest expense	1,000	
Discount allowed	1,500	
Interest income		2,000
Allowance for doubtful debts		2,200
Doubtful debts	200	
Land	120,000	
Bad debts	1,000	
Wages	12,500	
Insurance	4,700	
Electricity	2,400	

Additional information:

- The allowance for doubtful debts is to be set to \$2,700.
- Accrued wages at 30 June 2029 was \$900.
- Prepaid insurance at 30 June 2029 was 1,200.
- The income tax rate is 30%.
- Land was revalued to 150,000.

Required task:

Prepare a Statement of Comprehensive Income for Visco Girl Ltd for the year ended 30 June 2052.

Note: The Statement of Comprehensive Income includes fewer overall entries than an income statement. These fewer entries are made up of multiple entries added together and are demonstrated in each step of the worked solution. These entries will also require balance day adjustments (BDAs).

Solution

Step 1 – Revenue calculation.

Revenue =	<ul style="list-style-type: none">• Sales• (Less Discount Allowed)• (Less Sales returns)
------------------	--

$$\begin{aligned}\text{Revenue} &= 120,000 - 1,500 - 2,000 \\ &= 116,500\end{aligned}$$

Therefore, revenue is \$116,500.

Step 2 – Cost of Sales calculation.

Cost of Sales =	<ul style="list-style-type: none">• Cost of sales• Cartage inwards• (Less discount received)
------------------------	--

$$\begin{aligned}\text{Cost of sales} &= 46,000 + 400 - 2,100 \\ &= 44,300\end{aligned}$$

Therefore, cost of sales is \$44,300.

Step 3 – Other Income calculation.

Other Income =	<ul style="list-style-type: none">• Gain on sale of NCA• Interest received• Dividends received
-----------------------	--

$$\begin{aligned}\text{Other income} &= 2,000 + 7,000 \\ &= 9,000\end{aligned}$$

Note: there is no gain on sale of NCA in this example so this is not included in the calculation.

Therefore, other income is \$9,000.

Step 4 – Finance Expenses calculation.

Finance Expenses =	<ul style="list-style-type: none">• Interest expense• Loan interest
---------------------------	--

$$\begin{aligned}\text{Finance expenses} &= 2,500 + 1,000 \\ &= 3,500\end{aligned}$$

Therefore, finance expenses is \$3,500.

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Step 5 – Operating Expense calculation.

Operating Expenses =	<ul style="list-style-type: none">• Preliminary expenses• Doubtful debts• Wages Other expenses: <ul style="list-style-type: none">• Rent• Insurance• Electricity• Repairs and maintenance• Cleaning fees• Telephone• Preliminary expenses• Cartage outwards• Depreciation of NCA's• Loss on sale of NCA
-----------------------------	--

A series of balance day adjustments are required and are demonstrated below. For simplicity of this initial example demonstration only a few BDA's are demonstrated, practice of all BDA's is found in the practice questions.

Accrued wages BDA.

Wages expense = Wages paid + accrued wages
= 12,500 + 900
= 13,400

Doubtful Debts BDA.

Doubtful debts expense is found by reconstructing the Allowance for Doubtful Debts ledger account.

Allowance for Doubtful Debts					
Date	Desc.	\$	Date	Desc.	\$
	Bad debts	1,000		Balance b/d	2,200
	Balance c/d	2,700		Doubtful debts	1,500
		3,700			3,700
				Balance b/d	2,700

Therefore, doubtful debts expense is 1,500.

Prepaid insurance.

Insurance expense = insurance paid – prepaid insurance
= 4,700 – 1,200
= 3,500

Depreciation expense.

= 6,000

This was provided in the trial balance in the question. However, you may have to calculate this in some questions.

Note: There are practice depreciation questions in the balance day adjustments section. The depreciation chapter from the year 11 practical guide is also available on the resource hub linked at the start of this book. If you need to practice this beyond the practice questions in this chapter, you can practice the questions in the year 11 practical guide sample chapter.

The operating expenses relevant to this question are added together after the BDA's have been carried out.

Operating expenses = wages + doubtful debts + insurance + electricity + depreciation
= 13,400 + 1,000 + 3,500 + 2,400 + 6,000
= 26,300

Therefore, operating expenses is \$26,300.

Step 6 – SCI Preparation.

The Statement of Comprehensive Income is prepared below using calculations from previous steps.

Visco Girl Ltd Statement of Comprehensive Income For the year ended 30 June 2052	
Revenue	116,500
Less Cost of Sales	(44,300)
Gross Profit	72,200
Add Other Income	9,000
Less Finance Expenses	(3,500)
Less Operating Expenses (includes Other expenses)	(26,300)
Profit before Tax	51,400
Less Income Tax Expense	(15,420)
Profit after Tax	35,980
Add Other Comprehensive Income	
Gain on Asset Revaluation	30,000
Total Comprehensive Income for the Period	65,980

Income tax = Profit before tax x Tax rate
= 51,400 x 0.3
= 15,420

Gain on Land Revaluation = New valuation – Old valuation
= 150,000 – 120,000
= 30,000

The asset revaluation increase is not revenue and appears after profit after tax in the “Add Other Comprehensive Income” section.

Balance Day Adjustments Revision

It is recommended to revise balance day adjustments to support preparation of the SCI and SCF. See Tips below for details of a range of activities available for download from the Resource Hub.

Practice Questions

Questions 44-46: Statement of Comprehensive Income.

Balance day adjustment revision activities

Balance day adjustments were covered during the year 11 course and students may need to revise this. On the 'Sample Chapters' page of the Resource Hub linked on the front page of the book, there is a series of balance day adjustment revision activities that involve preparing BDA ledgers for calculation of figures that are needed to find figures for the Statement of Comprehensive Income and other financial statements. Students can view these activities digitally on their devices or teachers may want to print these for students.

Tips

Balance Day Adjustment Support

A summary of balance day adjustments practical and theory is provided on the following pages. This is useful to refer to during initial practice. This is also in the Course Guide which may be easier to keep open whilst completing practice questions rather than flipping pages. The Course Guide can be found by navigating to the Resource Hub link on the front page.

Statement of Comprehensive Income example

After the BDA summaries is an example Statement of Comprehensive Income. This is useful to refer to during initial practice. This is also in the Course Guide which may be easier to keep open whilst completing practice questions rather than flipping pages. The Course Guide can be found by navigating to the Resource Hub link on the front page.

Balance Day Adjustments – Practical Summary

Adjustment	Account to adjust	What to do	Workings	Account	Where adjustment goes
Prepaid Expense or Stock of Supplies	Prepaid Expense or Stock of Supplies Current Asset ↓ Expense	Reduce the amount of prepaid expense that was used.	$C\ Bal = O\ Bal - Total\ Expense$ OR $Total\ Expense = O\ Bal + Expense\ Paid - C\ Bal$ OR $Expense\ Paid = C\ Bal + Total\ Expense - O\ Bal$	Prepaid Expense O Bal Total Expense Expense paid (CAB) Closing Prepaid	Closing Balance • Statement of FP. Total Expense: • Income budget. • Statement of Comprehensive Income. Expense Paid: • Cash budget. • Statement of CF.
Accrued Expense	Expense Account Current Liability ↓ Expense	Add expense owing to expense account.	$Total\ Expense = Expense\ Paid + C\ Bal$ OR $Total\ Expense = Expense\ Paid + C\ Bal - Opening\ Accrued$ OR $Expense\ Paid = Total\ Expense - C\ Bal$ OR $Expense\ Paid = Opening\ Accrued + Total\ Expense - C\ Bal$	Accrued Expense Expense Paid (CAB) O Bal C Bal Total Expense	Closing Balance • Statement of FP. Total Expense: • Income budget. • Statement of Comprehensive Income. Expense Paid: • Cash budget. • Statement of CF.
Unearned Income / Income Received in Advance	Income Received in Advance Current Liability ↓ Income	Reduce the Income Received in Advance by the amount earned.	$C\ Bal = O\ Bal - Total\ Income$ OR $Total\ Income = O\ Bal + Income\ Received - C\ Bal$ OR $Income\ Received = C\ Bal + Total\ Income - O\ Bal$	Income Received in Advance Total Income O Bal C Bal Income Received (CAB)	Closing Balance • Statement of FP. Total Income: • Income budget. • Statement of Comprehensive Income. Income Received: • Cash budget. • Statement of CF.
Accrued Income	Income Account Current Asset ↓ Income	Add income earned but not yet received to income account.	$Total\ Income = Income\ Received + C\ Bal$ OR $Total\ Income = Income\ received + C\ Bal - O\ Bal$ OR $Income\ Received = Total\ Income - C\ Bal$ OR $Income\ Received = O\ Bal + Total\ Income - C\ Bal$	Accrued Income O Bal Income Received (CAB) Total Income C Bal	Closing Balance • Statement of FP. Total Income: • Income budget. • Statement of Comprehensive Income. Income Received: • Cash budget. • Statement of CF.
Depreciation	Acc Dep Acc Dep ↓ Expense	Add this year's depreciation expense to Accumulated Depreciation.	$C\ Bal\ Acc\ Dep = O\ Bal + Depreciation$ OR $Depreciation = Sale\ of\ Asset + C\ Bal - O\ Bal$ <u>Straight-line method:</u> $Depreciation\ Per\ Annum = (Historical\ Cost - Residual\ Value) / Estimated\ Life$ <u>Reducing Balance method:</u> $Depreciation\ Per\ Annum = Carrying\ Value \times Depreciation\ Rate$	Accumulated Depreciation Sale of Asset O Bal C Bal Depreciation	Closing Balance • Statement of FP. Depreciation: • Income Budget. • Statement of Comprehensive Income.
Doubtful Debts	Allowance for D.D. A.D.D. ↓ Expense	Transfer doubtful debts that have become bad debts. Adjust doubtful debts and bad debts.	$Doubtful\ debts = Bad\ debts + C\ Bal - O\ Bal$ $Bad\ debts = O\ Bal + Doubtful\ Debts - C\ Bal = Bad\ Debts$	Allowance for Doubtful Debts Bad Debts O Bal C Bal Doubtful Debts	Closing Balance • Statement of FP. Doubtful debts / Bad Debts: • Income budget. • Statement of Comprehensive Income.

Balance Day Adjustments – Theory Summary

Theory		Prepaid expenses / Stock of Supplies	Accrued expense	Unearned Income / Income Received in Advance	Accrued income (Income earned but not received)	Depreciation	Doubtful debts
Nature	Conceptual Framework category of original account	Current Asset.	Current Liability.	Current Liability.	Current Asset.	Expense.	Expense.
	<p>How this account meets the conceptual framework definition?</p> <p><i>Note: in exam write the conceptual framework definition and then explain how each aspect of the definition is met.</i></p>	<p>“A present economic resource, controlled by the entity as a result of past events.”</p> <p>Right: The business has the right to use the prepaid expense.</p> <p>Economic resource: The use of this prepaid expense / supplies will generate economic benefit e.g. increase sales, provide electricity etc.</p> <p>Control: The use of the prepaid expense is only by the business.</p>	<p>“A present obligation of the entity to transfer an economic resource as a result of past events.”</p> <p>Obligation: The business has an obligation to pay for the expense.</p> <p>Entity to transfer an economic resource: The business must transfer money to pay for the expense.</p> <p>Result of past events: The expense incurred as a result of past events.</p>	<p>“A present obligation of the entity to transfer an economic resource as a result of past events.”</p> <p>Obligation: The business has an obligation to provide the good or service to the customer to earn income received.</p> <p>Entity to transfer an economic resource: The business must provide the economic resource to the customer.</p> <p>Result of past events: Income received in advance.</p>	<p>“A present economic resource, controlled by the entity as a result of past events.”</p> <p>Right: The business has the right to receive the income in the future.</p> <p>Economic resource: The business will receive income in the future.</p> <p>Control: The accrued income is earned by the business.</p>	<p>“decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.”</p> <p>Derecognition of asset: Asset’s historical cost is derecognised due to usage, wear & tear and obsolescence.</p> <p>Depreciation reduces the carrying value of assets and equity and does not increase liabilities.</p>	<p>“decreases in assets, or increases in liabilities, that result in decreases in equity, other than those relating to distributions to holders of equity claims.”</p> <p>Derecognition of asset: An asset is derecognised due to customers identified as being at risk of becoming bad debtors.</p>
Accounts Created	Accounts created	Expense.	Expense.	Income.	Income.	Expense.	Expense.
	Recognition process that creates the account	Derecognition of current asset.	Recognition of current liability.	Derecognition of current liability.	Recognition of the current asset.	Derecognition of depreciable non-current asset.	Derecognition of current asset (accounts receivable).
Purpose (of the adjusting entry)	Purpose overview	To record expenses consumed at balance date.	To record expenses incurred but not yet paid as at balance date.	To record income earned at balance date.	To record income earned but not yet received at balance date.	To record the decline in the future economic benefit of asset.	To record debtors who are unlikely to pay their accounts.
	Effect on Balance Sheet	•Current assets decreased.	•Current liabilities increased.	•Current liabilities decreased.	•Current assets increased.	•Non-current assets decreased.	•Current asset decreased.
	Effect on Income Statement	•Expenses increased. •Profit decreased.	•Expenses increased. •Profit decreased.	•Income increased. •Profit increased.	•Income increased. •Profit increased.	•Expenses increased. •Profit decreased.	•Expenses increased. •Profit decreased.
	Effect on balance sheet if not accounted for	•Current assets overstated.	•Current liabilities understated.	•Current liabilities overstated.	•Current assets understated.	•Non-current assets overstated.	•Current assets (debtors) over-estimated.
	Effect on income statement if not adjusted on balance day	•Expense understated. •Profit overstated.	•Expenses understated. •Profit overstated.	•Income understated. •Profits understated.	•Income understated. •Profit understated.	•Expenses understated. •Profits overstated.	•Expenses under-estimated. •Profit over-estimated.

Statement of Comprehensive Income – Statement Preparation

Key	<ul style="list-style-type: none"> • Green = positive figure. • Red = negative figure. • Blue = Total sum.
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Company Name Statement of Comprehensive Income For the year ended 30 June 20XX	
Revenue	X
Less Cost of Sales	(X)
Gross Profit	X
Add Other Income	X
Less Finance Expenses	(X)
Less Operating Expenses (includes Other expenses)	(X)
Profit before Tax	\$TOTAL
Less Income Tax Expense	(X)
Profit after Tax	\$TOTAL
Add Other Comprehensive Income	
Gain on Asset Revaluation	X
Total Comprehensive Income for the Period	\$TOTAL

Tips	<ul style="list-style-type: none"> • If the question does not include 'Cost of Sales,' do not include 'Cost of Sales' and 'Gross Profit' entries. • If other individual entries are not present in question, do not include that specific individual entry. • To find 'income tax expense' – multiply Profit before tax by the tax rate given in question.
-------------	---

Calculation of entries for the Statement of Comprehensive Income

Revenue	<ul style="list-style-type: none"> • Sales. • (Less Discount Allowed). • (Less Sales returns).
Cost of Sales	<ul style="list-style-type: none"> • Cost of sales. • Cartage inwards. • (Less discount received).
Other income	<ul style="list-style-type: none"> • Gain on sale of NCA. • Interest received. • Dividends received.
Finance expenses	<ul style="list-style-type: none"> • Interest expense. • Loan interest.
Operating Expenses	<ul style="list-style-type: none"> • Preliminary expenses. • Doubtful debts. • Wages. <p>Other expenses:</p> <ul style="list-style-type: none"> • Rent. • Insurance. • Electricity. • Repairs and maintenance. • Cleaning fees. • Telephone. • Preliminary expenses. • Cartage outwards. • Depreciation of NCA's. • Loss on sale of NCA.

Practice Questions

Questions 44-46: Statement of Comprehensive Income.

Tips

Statement of Comprehensive Income example

On the previous page is an example Statement of Comprehensive Income. This is useful to refer to during initial practice.

Keeping track

Tick off each item on the trial balance an additional information as you enter them into the SCI to help keep track of which items have been entered and which items remain.

Question 44

The following information has been supplied by Goji Berry Farms Ltd.

Goji Berry Farms Ltd Trial balance (extract) As at 30 June 2043		
	Debit \$	Credit \$
Freight outwards	400	
Freight inwards	800	
Discount received		200
Prepaid rent	6,000	
Sales		90,000
Cost of Sales	25,000	
Sales returns	3,000	
Discount allowed	1,500	
Wages	9,200	
Motor Vehicles	80,000	
Accumulated Depreciation of Motor Vehicles	58,000	
Gain on Sale of motor vehicle	5,000	
Land	200,000	
Depreciation of motor vehicles	10,000	
Accrued selling and distribution expense		3,700
Interest expense	700	

Additional information:

- Income tax rate is 30%.
- Land is revalued to reflect market value increase of \$50,000.
- A motor vehicle was sold for a gain of \$5,000.
- Prepaid rent to be adjusted to \$800.
- Selling and distribution expense paid was \$900.

Required task:

a. Prepare a statement of comprehensive income for the year ended 30 June 2043.

Workings

Goji Berry Farms Ltd Statement of Comprehensive Income For the year ended 30 June 2043	
Revenue	
Less Cost of Sales	
Gross Profit	
Add Other Income	
Less Finance Expenses	
Less Operating Expenses (includes Other expenses)	
Profit before Tax	
Less Income Tax Expense	
Profit after Tax	
Add Other Comprehensive Income	
Gain on Asset Revaluation	
Total Comprehensive Income for the Period	

Question 45

The following information has been supplied by Sunshine Fun Ltd.

Sunshine Fun Ltd Trial balance (extract) As at 30 June 2036		
	Debit \$	Credit \$
Allowance for doubtful debts		4,000
Bad debts	600	
Sales		150,000
Sales Returns	5,000	
Cost of sales	60,000	
Discount received		3,700
Preliminary expenses	2,000	
Maintenance fees	1,200	
Dividends received		3,400
Land	170,000	
Interest expense	2,500	
Prepaid advertising	2,000	

Additional information:

- Income tax rate is 30%.
- Advertising paid is \$5,000.
- Interest income received during the period is \$5,000.
- Land is revalued to reflect market value increase to \$190,000.
- Accrued interest income is \$1,200.
- Accrued interest expense is \$700.
- Prepaid advertising to be adjusted to \$600.
- Allowance for doubtful debts to be adjusted to \$5,200.
- Office equipment was purchased on 1 Feb 2036 for \$12,000. The residual value is \$4,000 and has a useful of 6 years. The office equipment is to be depreciated using straight line depreciation.

Required task:

a. Prepare a statement of comprehensive income for the year ended 30 June 2036.

Workings

Question 46

The following information has been supplied by Boab Builder Ltd.

Boab Builder Ltd Trial balance (extract) As at 30 June 2036		
	Debit \$	Credit \$
Unearned Income		15,000
Fees		90,000
Discount allowed	2,000	
Cost of sales	31,000	
Freight inwards	1,800	
Freight outwards	300	
Machinery	67,000	
Accumulated Depreciation of machinery		35,000
Accrued wages		600
Wages	12,800	
Other expenses	6,500	
Prepaid rent	8,000	
Telephone	900	
Interest income		700
Interest expense	2,600	

Additional information:

- Land is revalued to reflect market rate with an increase of \$36,000.
- Income tax rate is 30%.
- Unearned income to be adjusted to \$6,000.
- Machinery is to be depreciated using reducing balance method at a rate of 12% per annum.
- Adjust accrued wages to \$950.
- Prepaid rent to be adjusted to \$2000.
- Accrued interest income is \$150.

Required task:

a. Prepare a statement of comprehensive income for the year ended 30 June 2036.

Workings

Statement of Financial Position

The Statement of Financial Position is a summary of a company's assets, liabilities and equity. It is often referred to as a company balance sheet. There is no prescribed AASB format for SFP presentation. The AASB states that the SFP should detail a company's assets, liabilities and equity. At the end of the SFP is a series of notes to detail relevant information. These SFP notes to accounts are demonstrated in the second example.

Example

Torrential Umbrellas Limited has provided the following financial information.

Torrential Umbrellas Limited Trial Balance (Extract) As at 30 June 2049		
	Debit	Credit
Cash at Bank	36,000	
Accounts Receivable	18,000	
Allowance for Doubtful Debts		4,500
Inventory	30,000	
Term deposit (matures 1 Feb 2050)		
Prepaid rent	2,400	
Prepaid advertising	3,600	
Accrued Interest Income	1,000	
Land	40,000	
Asset Revaluation Reserve		20,000
Motor Vehicle	62,000	
Acc Dep of Motor Vehicle		21,000
Machinery	15,000	
Acc Dep of Machinery		3,800
Goodwill	50,000	
Long term investments	20,000	
Accounts Payable		24,000
Accrued Wages		3,300
Short term loan		4,000
Tax Payable		12,000
Mortgage		118,000
Share Capital		32,400
Retained Earnings		35,000
General Reserve		30,000

Required task:

Prepare a Statement of Financial Position for Torrential Umbrellas Limited for the year ended 30 June 2049.

Solution

Step 1 – Assets section preparation.

Cash and cash equivalents.

Cash of \$36,000 is entered in the SFP as Cash and cash equivalents. If the question contained cash as well as cash equivalents these would need to be added together. Cash and cash equivalents are explained in detail during the Cash Flows chapter.

	Cash	Cash equivalents
Define	<ul style="list-style-type: none">• Cash on hand and demand deposits.	<ul style="list-style-type: none">• Short term highly liquid investments (less than 3 months).• Readily convertible into cash of known amounts.• Low risk of value change.
Examples	<ul style="list-style-type: none">• Cash on hand (notes and coins).• Demand deposit: Money held in financial institutions that a business can withdraw without constraint on demand.	<ul style="list-style-type: none">• Term deposit with 3 months maturity (90 days).• Bank bills.• Commercial bills.• Money market deposits.• Bank overdraft.

Trade and other receivables.

This is made up of accounts receivable less allowance for doubtful debts.

$$= 18,000 - 4,500$$

$$= 13,500$$

Inventories.

This is the inventory of the company. This is \$40,000.

Financial assets

Financial assets are assets that arise due to future cash flows outlined in contractual agreements or from owning equity instruments of another entity. In this example, this is the term deposit of \$10,000.

Other current assets.

Other current assets contain less important current assets such as prepaid expenses and accrued income. The calculation in this example is:

$$\text{Other current assets} = \text{Prepaid rent} + \text{prepaid advertising} + \text{accrued interest income}$$

$$= 2,400 + 3,600 + 1,000$$

$$= 7,000$$

Property, plant and equipment.

Property, plant and equipment represents the Non-Current Assets added together, less the accumulated depreciation of these and add any asset revaluation increase.

$$= (\text{Land} + \text{Revaluation}) + (\text{Motor Vehicle} - \text{Acc Dep of MV}) + (\text{Machinery} - \text{Acc Dep of Machinery})$$

$$= (40,000 + 20,000) + (62,000 - 21,000) + (15,000 - 3,800)$$

$$= 112,200$$

Investments

Investments is a non-current asset and in this example is made up the trial balance entry of 'Long term investments'. Examples of non-current investments could be a term deposit for more than 12 months, bonds, shares in another company etc.

Goodwill.

Goodwill is an intangible asset of a business. It is the value of a business beyond the value of its assets less liabilities. This is made up of the value created by loyal customers, brand awareness, management excellence etc.

Total Assets is calculated once the Current and Non-Current Assets have been entered a totalled.
 Total Assets = Total Current Assets + Total Non-Current Assets

Current Assets	
Cash and Cash Equivalents	36,000
Trade and Other Receivables	13,500
Inventories	30,000
Financial assets	10,000
Other Current Assets	7,000
Total Current Assets	96,500
Non-Current Assets	
Property, Plant and Equipment	112,200
Investments	20,000
Goodwill	50,000
Total Non-Current Assets	182,200
Total Assets	278,700

Step 2 – Liabilities preparation.

Trade and other payables.

This is made up of accounts payable and accrued expenses. If unearned income is to be received within 12 months this would also make up trade and other payables. The calculation for this example is:

$$\begin{aligned} \text{Trade and other payables} &= \text{accounts payable} + \text{accrued wages} \\ &= 24,000 + 3,300 \\ &= 27,300 \end{aligned}$$

Short term borrowings.

This is made up of borrowings due for payments within 12 months. In this example this is the short term loan of \$4,000.

Tax payable

Tax payable in this example is \$12,000.

Long term borrowings.

This is made up of long term borrowings such as mortgage and debentures payable.

Total Liabilities is calculated once the Current and Non-Current Liabilities have been entered and totalled.

$$\text{Total Liabilities} = \text{Current Liabilities} + \text{Non-Current Liabilities}$$

$$\text{Net Assets} = \text{Total Assets} - \text{Total Liabilities}$$

$$\begin{aligned} &= 278,700 - 161,300 \\ &= 117,400 \end{aligned}$$

Current Liabilities	
Trade and other payables	27,300
Short term borrowings	4,000
Tax payable	12,000
Total Current Liabilities	43,300
Non-Current Liabilities	
Long-term borrowings	118,000
Total Non-Current Liabilities	118,000
Total Liabilities	161,300
Net Assets	117,400

Step 3 – Equity preparation.

Share Capital

Share Capital is made up of share capital less share issue costs. In this example there is no share issue costs listed separately. Therefore, share capital is taken directly from the trial balance at \$32,400.

Retained Earnings

Retained earnings is the profit remaining once dividends have been paid.

Other reserves

This contains the general reserve and asset revaluation reserve.

= 30,000 + 20,000

= 50,000

Equity	
Share Capital	32,400
Retained Earnings	35,000
Other reserves	50,000
Total Equity	117,400

Step 4 – Statement of Financial Position preparation.

The SFP is now prepared by collating sections completed in previous steps.

Note: Net Assets and Total Equity should be equal.

Torrential Umbrellas Limited	
Statement of Financial Position	
As at 30 June 2049	
Current Assets	
Cash and Cash Equivalents	36,000
Trade and other receivables	13,500
Inventories	30,000
Financial assets	10,000
Other current assets	7,000
Total Current Assets	96,500
Non-Current Assets	
Property, Plant and Equipment	112,200
Investments	20,000
Goodwill	50,000
Total Non-Current Assets	182,200
Total Assets	278,700
Current Liabilities	
Trade and other payables	27,300
Short term borrowings	4,000
Tax payable	12,000
Total Current Liabilities	43,300
Non-Current Liabilities	
Long-term borrowings	118,000
Total Non-Current Liabilities	118,000
Total Liabilities	161,300
Net Assets	117,400
Equity	
Share Capital	32,400
Retained Earnings	35,000
Other reserves	50,000
Total Equity	117,400

Notes to the Statement of Financial Position

The Statement of Financial Position is accompanied with a several notes to provide further detail to SFP entries.

The SFP notes covered in the syllabus include:

- Property, plant and equipment.
- Share capital.
- Reserves.
- Dividends.

Example

Butterfly House Pty Ltd has supplied the following information.

Butterfly House Pty Ltd Trial Balance (extract) As at 30 June 2035		
	Debit \$	Credit \$
Plant and equipment	95,000	
Accumulated depreciation – Plant and equipment		60,000
Accumulated depreciation – Furniture and fittings		35,000
Land	130,000	
Furniture and fittings	72,000	
General Reserve		90,000
Retained Earnings		95,000
Ordinary Share Capital, issued at \$1.00 each		100,000

Additional information:

- For the 2034 financial year, final dividends were \$0.10 per share and were paid on 15 September 2035.
- On 15 October 2034, an interim dividend of \$0.11 per share was declared and authorized. On 28 October 2034 the interim dividend was paid.
- On 5 January 2035, a prospectus was issued by the company for 50,000 ordinary shares at an issue price of \$1.10 per share. Applications were received for 45,000 shares by 23 January 2035. The directors allotted the shares on 15 February and paid \$2,500 share issue costs the same day.
- On 30 June 2035, the profit after tax for the financial year was \$33,000. Directors recommended that shareholders receive a final dividend of \$0.13 per share. At the 2035 annual general meeting, this was approved by shareholders.
- On 30 June 2035, the directors transferred \$10,000 to retained earnings from the general reserve.
- Land was revalued upwards by \$40,000.

Required task:

Prepare the following notes to the account for Butterfly House Pty for the year ended 30 June 2035.

- Property, plant and equipment.
- Share capital.
- Other reserves.
- Dividends.

Solution

Step 1 – Property, plant and equipment note preparation.

Relevant information from the question to prepare this note:

	Debit \$	Credit \$
Plant and equipment	95,000	
Accumulated depreciation – Plant and equipment		60,000
Accumulated depreciation – Furniture and fittings		35,000
Land	130,000	
Furniture and fittings	72,000	

Additional information:

- Land was revalued upwards by \$40,000.

The property, plant and equipment note to the SFP is set out below. The total property, plant and equipment is calculated at the end by adding together the totals of each subcomponent.

Property, plant and equipment	
Land (at cost)	130,000
Add asset revaluation	40,000
	<u>170,000</u>
Furniture and fittings (at cost)	72,000
Less Accumulated depreciation of furniture and fittings	(35,000)
	<u>37,000</u>
Plant and equipment (at cost)	95,000
Less Accumulated depreciation of plant and equipment	(60,000)
	<u>35,000</u>
Total property, plant and equipment	<u>\$242,000</u>

The SFP only contains the total property, plant and equipment value of \$242,000. This note is included with the SFP to elaborate on what makes up property, plant and equipment.

This space has been left blank intentionally so that the next step can fit on one page.

Step 2 – Share capital note preparation.

Relevant information from the question:

	Debit \$	Credit \$
Ordinary Share Capital, issued at \$1.00 each		100,000

Additional information:

- On 5 January 2035, a prospectus was issued by the company for 50,000 ordinary shares at an issue price of \$1.10 per share. Applications were received for 45,000 shares by 23 January 2035. The directors allotted the shares on 15 February and paid \$2,500 share issue costs the same day.

The workings and note for the share capital note to the SFP is set out below.

Opening number of shares = Ordinary share total / issue price of ordinary shares
= 100,000 / 1.00
= 100,000 ordinary shares

Value of share capital issued = Number of shares issued x share issue value – share issue costs
= (45,000 shares issued x \$1.1) – 2,500
= 47,000

Share Capital	
100,000 ordinary shares @ \$1.00 each, fully paid	100,000
45,000 ordinary shares @ \$1.10 each, fully paid less share issue costs	47,000
Total share capital	147,000

The SFP only contains the total share capital value of \$147,000. This note is included with the SFP to elaborate on what makes up share capital.

Step 3 – Other reserves note preparation.

Relevant information from the question:

	Debit \$	Credit \$
General Reserve		90,000
Retained Earnings		95,000

Additional information:

- On 30 June 2035, the directors transferred \$10,000 to retained earnings from the general reserve.
- Land was revalued upwards by \$40,000.

The workings and note for the other reserves note to the SFP is set out below.

General reserve = Opening balance – Transfer to/from general reserve
= 90,000 – 10,000
= 80,000

Asset revaluation reserve matches the asset revaluation from the note to property, plant and equipment.

Other reserves	
General reserve	80,000
Asset revaluation reserve	40,000
Total reserves	120,000

The SFP only contains the total reserves value of \$120,000. Retained earnings is a separate entry in the equity section of the SFP. This note is included with the SFP to elaborate on what makes up other reserves.

Step 4 – Dividends note preparation.

The workings and note for the dividends note to the SFP is set out below.

Relevant information from the question:

- For the 2034 financial year, final dividends were \$0.10 per share and were paid on 15 September 2035.

Final dividend paid from previous financial year = Number of ordinary shares x dividend per share
= 100,000 x 0.10
= 10,000

Relevant information from the question:

- On 15 October 2034, an interim dividend of \$0.11 per share was declared and authorized. On 28 October 2034 the interim dividend was paid.

Interim dividend paid = Number of ordinary shares x dividend per share
= 100,000 x 0.11
= 11,000

Relevant information from the question:

- On 30 June 2035, the profit after tax for the financial year was \$33,000. Directors recommended that shareholders receive a final dividend of \$0.13 per share. At the 2035 annual general meeting, this was approved by shareholders.

Note: Shares were issued prior to the final dividend taking place.

Final dividend declared = number of ordinary shares x dividend per share
= 145,000 x 0.13
= 18,850

Dividends	
Dividends paid as at 30 June 2034	
Final dividend as per 2034 AGM 100,000 Ordinary shares @ \$0.10 per share	10,000
Interim dividends 100,000 Ordinary shares @ \$0.11 per share	11,000
Dividends recommended by Directors:	
Final dividend 145,000 Ordinary shares @ \$0.13 per share	18,850

Note: The Dividends note is not totalled like the other notes were. Dividends appear in the statement of Changes in Equity. This note is included with the SFP on relevant dividends.

Practice Questions

Questions 47-49: Statement of Financial Position and Notes to the Statement of Financial Position.

Questions 50-70: Companies theory review.

Exam Questions

See 'Companies' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Tips	<p><u>Statement of Financial Position example</u> On the following page is an example Statement of Financial Position. This is useful to refer to during initial practice.</p>
	<p><u>Notes to the Statement of Financial Position example</u> On the following page is an example Notes to the Statement of Financial Position. This is useful to refer to during initial practice.</p>
	<p><u>Label the question</u> Label the question and additional information with which section of the SFP each entry belongs to. I.e. label the trial balance with CA, NCA, CL, NCL or EQ to remind you which items need to go into each section of the SFP.</p>
	<p><u>Keeping track</u> As you add entries from the question to your workings or statement tick or cross the CA, NCA, CL, NCL or EQ note you made next to them to keep track of which ones you have completed. This should help to prevent you from forgetting to include any entries from the SFP.</p>

Statement of Financial Position – Statement Preparation

Key	<ul style="list-style-type: none"> • Green = assets. • Red = liabilities. • Blue = equity.
------------	---

Company Name Statement of Financial Position As at 30 June 20XX	
Current Assets	
Cash and Cash Equivalents	
Trade and other receivables	
Inventories	
Financial assets	
Other current assets	
Total Current Assets	\$TOTAL
Non-Current Assets	
Property, Plant and Equipment	
Investments	
Goodwill	
Total Non-Current Assets	\$TOTAL
Total Assets	CA + NCA
Current Liabilities	
Trade and other payables	
Short term borrowings	
Tax payable	
Total Current Liabilities	\$TOTAL
Non-Current Liabilities	
Long-term borrowings	
Total Non-Current Liabilities	\$TOTAL
Total Liabilities	CL + NCL
Net Assets	TA – TL
Equity	
Share Capital	
Retained Earnings	
Other reserves	
Total Equity	\$TOTAL

Calculation of entries for the Statement of Financial Position

Category	Entry	Examples
Current Assets	Cash and cash equivalents	If the question contains cash as well as cash equivalents these would need to be added together. See the Cash and cash equivalents summary table that follows this table for definitions and examples. Cash and cash equivalents are explained in detail during the Cash Flows chapter.
	Trade and other receivables	<ul style="list-style-type: none"> • Accounts receivable. • Less allowance for doubtful debts.
	Inventories	<ul style="list-style-type: none"> • Inventory of the company.
	Financial assets	Current Assets that arise due to future cash flows outlined in contractual agreements or from owning equity instruments of another entity. <ul style="list-style-type: none"> • Term deposits. • Cash management trusts. • Money markets. <i>Tip: Think of Current Asset examples from the investment options chapter.</i>
	Other current assets	Contains less important current assets such as: <ul style="list-style-type: none"> • Prepaid expenses. • Accrued income.
Non-Current Assets	Property, Plant and Equipment	<ul style="list-style-type: none"> • Non-Current Assets added together. • Less the accumulated depreciation of these NCAs. • Add any asset revaluation increase.
	Investments	<ul style="list-style-type: none"> • Shares. • Term deposits. • Debentures. • Unsecured notes. • Trusts. <i>Tip: Think of Non-Current Asset examples from the investment options chapter.</i>
	Goodwill	An intangible asset of a business. It is the value of a business beyond the value of its assets less liabilities. This is made up of the value created by loyal customers, brand awareness, management excellence etc.
Current Liabilities	Trade and other payables	<ul style="list-style-type: none"> • Accounts payable. • Accrued expenses. • Unearned income received within 12 months.
	Short term borrowings	Borrowings due for payments within 12 months. <ul style="list-style-type: none"> • Short term loan. • Bank overdraft. • Credit from suppliers. • Commercial bills. • Debt factoring. <i>Tip: Think of Current Liability examples from the sources of finance chapter.</i>
Non-Current Liabilities	Long-term borrowings	Borrowings due for payments within more than 12 months, such as: <ul style="list-style-type: none"> • Loans. • Mortgage. • Leasing. • Debentures. • Unsecured notes. • Commercial bills. <i>Tip: Think of Non-Current Liability examples from the sources of finance chapter.</i>
Equity	Share Capital	<ul style="list-style-type: none"> • Share capital. • Less share issue costs.
	Retained Earnings	The profit remaining once dividends have been paid.
	Other reserves	<ul style="list-style-type: none"> • General reserve. • Asset revaluation reserve.

Note: There is no prescribed AASB format for SFP presentation. The AASB states that the SFP should detail a company's assets, liabilities and equity.

Cash and cash equivalents – Summary Table

	Cash	Cash equivalents
Define	<ul style="list-style-type: none"> Cash on hand and demand deposits. 	<ul style="list-style-type: none"> Short term highly liquid investments (less than 3 months). Readily convertible into cash of known amounts. Low risk of value change.
Examples	<ul style="list-style-type: none"> Cash on hand (notes and coins). Demand deposit: Money held in financial institutions that a business can withdraw without constraint on demand. 	<ul style="list-style-type: none"> Term deposit with 3 months maturity (90 days). Bank bills. Commercial bills. Money market deposits. Bank overdraft.

Notes to the Statement of Financial Position

Key	
	• Green = positive figure.
	• Red = negative figure.
	• Blue = Total sum.

Description of note	Notes to the Account																						
Property, plant and equipment Non-current asset changes	<table border="1"> <thead> <tr> <th colspan="2">Property, plant and equipment</th> </tr> </thead> <tbody> <tr> <td>Land (at cost)</td> <td>X</td> </tr> <tr> <td>Add asset revaluation</td> <td>X</td> </tr> <tr> <td></td> <td>\$TOTAL</td> </tr> <tr> <td>Furniture and fittings (at cost)</td> <td>X</td> </tr> <tr> <td>Less Accumulated depreciation of furniture and fittings</td> <td>(X)</td> </tr> <tr> <td></td> <td>\$TOTAL</td> </tr> <tr> <td>Plant and equipment (at cost)</td> <td>X</td> </tr> <tr> <td>Less Accumulated depreciation of plant and equipment</td> <td>(X)</td> </tr> <tr> <td></td> <td>\$TOTAL</td> </tr> <tr> <td>Total property, plant and equipment</td> <td>\$TOTAL</td> </tr> </tbody> </table>	Property, plant and equipment		Land (at cost)	X	Add asset revaluation	X		\$TOTAL	Furniture and fittings (at cost)	X	Less Accumulated depreciation of furniture and fittings	(X)		\$TOTAL	Plant and equipment (at cost)	X	Less Accumulated depreciation of plant and equipment	(X)		\$TOTAL	Total property, plant and equipment	\$TOTAL
Property, plant and equipment																							
Land (at cost)	X																						
Add asset revaluation	X																						
	\$TOTAL																						
Furniture and fittings (at cost)	X																						
Less Accumulated depreciation of furniture and fittings	(X)																						
	\$TOTAL																						
Plant and equipment (at cost)	X																						
Less Accumulated depreciation of plant and equipment	(X)																						
	\$TOTAL																						
Total property, plant and equipment	\$TOTAL																						
Share Capital Details the number of shares and the changes in shares	<table border="1"> <thead> <tr> <th colspan="2">Share Capital</th> </tr> </thead> <tbody> <tr> <td>(Number of) ordinary shares @ (price) each, fully paid</td> <td>X</td> </tr> <tr> <td>(Number of) ordinary shares @ (price) each, fully paid less share issue costs</td> <td>X</td> </tr> <tr> <td>Total share capital</td> <td>\$TOTAL</td> </tr> </tbody> </table>	Share Capital		(Number of) ordinary shares @ (price) each, fully paid	X	(Number of) ordinary shares @ (price) each, fully paid less share issue costs	X	Total share capital	\$TOTAL														
Share Capital																							
(Number of) ordinary shares @ (price) each, fully paid	X																						
(Number of) ordinary shares @ (price) each, fully paid less share issue costs	X																						
Total share capital	\$TOTAL																						
Other components of equity (Reserves) Includes general reserve and asset revaluation reserve.	<table border="1"> <thead> <tr> <th colspan="2">Other components of equity (Reserves)</th> </tr> </thead> <tbody> <tr> <td>General reserve</td> <td>X</td> </tr> <tr> <td>Asset revaluation reserve</td> <td>X</td> </tr> <tr> <td>Total reserves</td> <td>\$TOTAL</td> </tr> </tbody> </table>	Other components of equity (Reserves)		General reserve	X	Asset revaluation reserve	X	Total reserves	\$TOTAL														
Other components of equity (Reserves)																							
General reserve	X																						
Asset revaluation reserve	X																						
Total reserves	\$TOTAL																						
Dividends Details all recognized and unrecognized dividends.	<table border="1"> <thead> <tr> <th colspan="2">Dividends</th> </tr> </thead> <tbody> <tr> <td colspan="2">Dividends paid as at 30 June 20XX:</td> </tr> <tr> <td>Final dividend as per 20XX AGM (Number) Ordinary shares @ (price) per share</td> <td>X</td> </tr> <tr> <td>Interim dividends (Number of) Ordinary shares @ (price) per share</td> <td>X</td> </tr> <tr> <td colspan="2">Dividends recommended by Directors:</td> </tr> <tr> <td>Final dividend (Number of) Ordinary shares @ (price) per share</td> <td>X</td> </tr> </tbody> </table>	Dividends		Dividends paid as at 30 June 20XX:		Final dividend as per 20XX AGM (Number) Ordinary shares @ (price) per share	X	Interim dividends (Number of) Ordinary shares @ (price) per share	X	Dividends recommended by Directors:		Final dividend (Number of) Ordinary shares @ (price) per share	X										
Dividends																							
Dividends paid as at 30 June 20XX:																							
Final dividend as per 20XX AGM (Number) Ordinary shares @ (price) per share	X																						
Interim dividends (Number of) Ordinary shares @ (price) per share	X																						
Dividends recommended by Directors:																							
Final dividend (Number of) Ordinary shares @ (price) per share	X																						

Question 47

Munchers Mulch Limited has provided the following information.

Munchers Mulch Limited Trial Balance (extract) As at 30 June 2033		
	Debit \$	Credit \$
Cash at Bank	12,000	
Accounts Receivable	62,000	
Allowance for Doubtful Debts		3,600
Inventory	67,000	
Prepaid Insurance	2,400	
Accrued Interest Income	2,100	
Land	260,000	
Motor Vehicle	50,000	
Accumulated Depreciation – Motor Vehicle		21,000
Machinery	16,000	
Accumulated Depreciation – Machinery		6,200
Goodwill	30,000	
Term deposit maturing 1 December 2033	4,000	
Accounts Payable		50,000
Borrowings		160,000
Debentures		61,700
Ordinary Share Capital, issued at \$2.05		102,500
Retained Earnings (1 July 2032)		35,000
General Reserve		30,000

Additional Information:

- The final dividend of \$0.13 per share declared at the annual general meeting in 2032 was paid on 3 August 2032.
- On 30 June 2033, the directors transferred \$10,000 to retained earnings from the general reserve.
- At the upcoming annual general meeting, directors have resolved to recommend a \$0.18 dividend per share.
- Profit for the period was \$42,000. The company tax rate is 30%.
- Land was revalued with an increase in value of \$20,000.

Required tasks:

a. Prepare the retained earnings ledger account as at 30 June 2033.

Hint: the final dividend for the year ended 30 June 2033 is not included in this retained earnings account given it will not be approved by shareholders until the following financial year.

Profit after tax =

Number of ordinary shares =

Final dividend payable for previous financial year =

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$
3 Aug 2032	Final Dividend Payable	6,500	1 Jul 2032	Balance b/d	35,000

b. Prepare a statement of financial position for the year ended 30 June 2042.

Workings

Munchers Mulch Limited Statement of Financial Position As at 30 June 2033	
Current Assets	
Cash and Cash Equivalents	
Trade and other receivables	
Inventories	
Financial assets	
Other current assets	
Total Current Assets	
Non-Current Assets	
Property, Plant and Equipment	
Goodwill	
Total Non-Current Assets	
Total Assets	
Current Liabilities	
Trade and other payables	
Tax payable	
Total Current Liabilities	
Non-Current Liabilities	
Long-term borrowings	
Total Non-Current Liabilities	
Total Liabilities	
Net Assets	
Equity	
Share Capital	
Retained Earnings	
Other reserves	
Total Equity	

c. Prepare the notes to the accounts for the year ended 30 June 2033.

Munchers Mulch Limited Notes to the Accounts As at 30 June 2033	
Property, plant and equipment	
Total property, plant and equipment	
Share Capital	
Total share capital	
Other reserves	
Total reserves	
Dividends	
Dividends paid as at 30 June 2033:	
Dividends recommended by Directors:	

Question 48

Moments Framers Ltd has provided the following information.

Moments Framers Ltd Trial Balance (extract) As at 30 June 2042		
	Debit \$	Credit \$
Cash at Bank	15,000	
Accounts Receivable	34,000	
Allowance for Doubtful Debts		2,400
Inventory	65,000	
Prepaid Rent	2,500	
Accrued Interest Income	1,200	
Land	160,000	
Furniture and Fittings	23,000	
Term deposit maturing 1 April 2043	2,000	
Accumulated Depreciation – Furniture and Fittings		4,100
Machinery	15,600	
Accumulated Depreciation – Machinery		8,300
Goodwill	10,000	
Long term investments	10,000	
Accrued Selling and Distribution expense		4,000
Accounts Payable		12,000
Short term loan		4,000
Mortgage		205,300
Ordinary Share Capital, issued at \$1.10		49,500
Retained Earnings (1 July 2041)		20,000
General Reserve		10,000

Additional Information

- The final dividend of \$0.10 per share declared at the annual general meeting in 2041 was paid on 10 September 2041.
- An interim dividend of \$0.04 was declared and paid on 2 February 2042.
- On 30 June 2042, the directors transferred \$5,000 to the general reserve from retained earnings.
- At the upcoming annual general meeting, directors have resolved to recommend a \$0.12 dividend per share.
- Profit for the period was \$25,000. The company tax rate is 30%.
- Land was revalued with an increase of \$10,300.

Required tasks:

a. Prepare the retained earnings ledger account.

Hint: the final dividend for the year ended 30 June 2042 is not included in this retained earnings account given it will not be approved by shareholders until the following financial year.

Workings

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$

b. Prepare a statement of financial position for the year ended 30 June 2042.

Workings

Question 49

Accounting One Ltd has provided the following information.

Accounting One Ltd Trial Balance (extract) As at 30 June 2057		
	Debit \$	Credit \$
Cash at Bank	27,000	
Accounts Receivable	85,000	
Allowance for Doubtful Debts		6,000
Inventory	92,000	
Prepaid Insurance	4,200	
Accrued Interest Income	800	
Land	290,000	
Asset Revaluation Reserve		10,000
Furniture and Fittings	20,000	
Accumulated Depreciation – Furniture and Fittings		7,000
Accounts Payable		30,000
Accrued wages		2,500
Borrowings		100,000
Debentures		47,700
Ordinary Share Capital, issued at \$0.90 (1 July 2056)		135,000
Retained Earnings (1 July 2056)		75,000
General Reserve		60,000

Additional Information

- The final dividend of \$0.12 per share declared at the annual general meeting in 2056 was paid on 14 August 2056.
- An interim dividend of \$0.08 was declared and paid on 14 Jan 2057.
- On 30 June 2057, the directors transferred \$15,000 from the general reserve to retained earnings.
- On 5 March 2057, a prospectus was issued by the company for 40,000 ordinary shares at an issue price of \$1.10 per share. Applications were received for all shares by 18 March 2057. The directors allotted the shares on 22 March and paid \$3,200 share issue costs the same day.
- At the upcoming annual general meeting, directors have resolved to recommend a \$0.15 dividend per share.
- Profit for the period was \$60,000.
- The company tax rate is 30%.
- Land was revalued with an increase in value of \$60,000.

Required tasks:

a. Prepare the retained earnings ledger account.

Workings

Retained Earnings					
Date	Desc.	\$	Date	Desc.	\$

b. Prepare a statement of financial position for the year ended 30 June 2057.

Workings

Practice Questions

Questions 50-70: Companies theory review.

Tip

Course Guide

When completing the theory review you may find it useful to refer to the relevant chapter in the Essential Insight Course Guide. The Course Guide summarizes all theory relevant for each practical guide chapter. This saves time flipping through multiple pages in the Practical Guide while revising. The Course Guide can be found by navigating to the Resource Hub link on the front page.

Question 50

Interest expense would be a component of which entry for the Statement of Comprehensive Income?

- a. Other Income.
- b. Finance expenses.
- c. Operating Expenses
- d. Cost of Sales.

Question 51

Identify which of the following is not included in the Director's report.

- a. Core goals.
- b. Business strategies.
- c. Statement of Changes in Equity.
- d. List of directors and their remuneration.

Question 52

The replaceable rules can be substituted with:

- a. Prospectus.
- b. Company constitution.
- c. Director's report.
- d. Ordinary shareholders.

Question 53

In the Statement of Financial Position, goodwill is an example of:

- a. Current Assets.
- b. Equity.
- c. Non-Current Assets.
- d. Current Liabilities.

Question 54

The statement of financial position does not include.

- a. Assets.
- b. Shareholders' equity.
- c. Liabilities.
- d. Profit or loss.

Question 55

Which of the following is a right of preference shareholders.

- a. No specific dividend rights.
- b. Can vote at the annual general meeting.
- c. Last to receive liquidation payment.
- d. Can sell shares without restriction.

Question 62

Outline the following negative characteristics of companies.

- Continuity of existence
- Separation of ownership and management
- Costs

Question 63

Compare the Statement of Comprehensive Income and Statement of Financial Position with regards to what each report:

- Enables users to evaluate about the company.
- Measures and reports.

Question 64

List items that may be included in a director's report.

Question 65

How would the managers control of a proprietary company change if the entity became a public company?

Question 66

Describe the purpose of the annual general meeting of a public company.

Question 67

Company large proprietary companies and public companies with regards to:

- Issue of securities.
- Annual general meeting.
- Audit of financial statements.
- Legislative interference.



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18. Cash Flows



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>Why would a business want to know how much cash is coming into and out of a business?</p>	
<p>Some businesses can be profitable but have issues with cash flow. What could cause this?</p>	
<p>Businesses can spend money in several different areas. What different areas do you think a business could classify its cash flows as?</p>	

Cash Flows – Syllabus

Syllabus – Unit 4	
Cash Flows	<p>Financial institutions and systems: Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • Statement of Cash Flows as per AASB 107, including: <ul style="list-style-type: none"> ▪ benefits of the cash flow statement information ▪ concepts of cash and cash equivalents <p>Recording, using and evaluating financial information: Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • cash flow statement from comparative balance sheets and income statements using the direct method only – notes not required and GST not included <p>Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • interpretation of the movements in cash flow items

Cash Flows – Introduction

The statement of cash flows is a financial statement that summarises a company's cash inflows and outflows over a specific period. It is a key component of a company's annual report and is one of the general purpose financial reports (GPFs). The creation of a statement of cash flows enables users to gain insights into the financial position of a company and enhances the comparison of the business with other entities.

The statement of cash flows analyses cash flows in three key areas; operating activities, investing activities and financing activities.

Some students may falsely assume that if a business is profitable that it may be free from any significant issues. The statement of cash flows can highlight cash flow problems that may be occurring in a business that is otherwise profitable which can then allow for the development of recommendations to remedy these issues.

To prepare a statement of cash flows, reconstructions of general ledgers are required. These reconstructions use information found in the statement of financial position and statement of comprehensive income to calculate varied specific cash flows that have taken place.

Structure of this chapter

- Statement of Cash Flows introduction theory.
- Interpretation of Statement of Cash Flows.
- Preparation of a Statement of Cash Flows without reconstructions.
- Reconstructions of accounts required to prepare a Statement of Cash Flows.
- Preparation of Statement of Cash Flows using reconstructions.
- Other Statement of Cash Flows theory.

Statement of Cash Flows – Introduction and Summary Table

The nature and purpose of the Statement of Cash Flows (SCF) is outlined below.

Statement of Cash Flows	
Nature / Define	Provides information about cash received and paid by the entity.
Purpose / Benefit of information (financial position insight gained) <i>Know any 4</i>	<ul style="list-style-type: none"> • Evaluates: <ul style="list-style-type: none"> ○ Cash in – ability to generate cash flows. ○ Cash out – entity's needs that use cash flows. ○ Entity's ability to generate positive future cash flows. ○ Financial position changes. ○ Liquidity / solvency changes – ability to pay debts. ○ Capacity to tweak timing and amounts of cash flows in response to changing circumstances. • Enhances comparison of: <ul style="list-style-type: none"> ○ Operating performance of varied entities. ○ Profitability and net cash flows. ○ Past assessment of cash flow accuracy.

Cash and cash equivalents

The SCF is made up of inflows and outflows of cash and cash equivalents as specified by AASB 107.

	Cash	Cash equivalents
Define	<ul style="list-style-type: none">Cash on hand and demand deposits.	<ul style="list-style-type: none">Short term highly liquid investments (less than 3 months).Readily convertible into cash of known amounts.Low risk of value change.
Examples	<ul style="list-style-type: none">Cash on hand (notes and coins).Demand deposit: Money held in financial institutions that a business can withdraw without constraint on demand.	<ul style="list-style-type: none">Term deposit with 3 months maturity (90 days).Bank bills.Commercial bills.Money market deposits.Bank overdraft.

Preparation and Interpretation of a Statement of Cash Flows without reconstructions

The Statement of Cash Flows is made up of the following sections.

SCF Section	Nature	Examples
Cash flows from operating activities	The principal revenue-producing activities of the entity and other activities that are not investing or financing activities.	<ul style="list-style-type: none">Receipts from customers.Dividend received.Payments to suppliers and employees.Interest paid (if for current liability).Income tax paid.
Cash flows from investing activities	The acquisition and disposal of long-term assets and other investments not included in cash equivalents.	<ul style="list-style-type: none">Interest received.Proceeds of sale of investments.Proceeds of sale of plant and equipment.Payment for Investments.Payment for NCA's / Purchase of NCA's.
Cash flows from financing activities	Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.	<ul style="list-style-type: none">Proceeds from borrowings / loan.Share capital proceeds / Additional share capital.Debentures issued.Repayment of borrowings / loan.Repayment of debentures.Interest paid (if for non-current liability).Dividends paid.Share issue costs.

Note: The nature of each activity section comes from AASB 107: Statement of Cash Flows.

Below is an example of a completed statement of cash flows.

Key	<ul style="list-style-type: none"> • Green = positive figure. • Red = negative figure. • Grey = positive or negative • Blue = heading.
------------	--

Company Name Statement of Cash Flows for the year ended 30 June 20XX	
Cash flows from operating activities	
Receipts from customers	X
Payments to suppliers and employees	(X)
Interest paid (if for current liability)	(X)
Income tax paid	(X)
Net cash from operating activities	\$TOTAL
Cash flows from investing activities	
Interest received	X
Dividends received	X
Proceeds of sale of investments	X
Proceeds of sale of plant and equipment	X
Payment for Investments	(X)
Payment for NCA's / Purchase of NCA's	(X)
Net cash from investing activities	\$TOTAL
Cash flows from financing activities	
Proceeds from borrowings / loan	X
Share capital proceeds / Additional share capital	X
Debentures issued	X
Repayment of borrowings / loan	(X)
Repayment of debentures	(X)
Interest paid (if for non-current liability)	(X)
Dividends paid	(X)
Share issue costs	(X)
Net cash from financing activities	\$TOTAL
Net increase/decrease in cash held	X or (X)
Cash and cash equivalents at start of period	START
Cash and cash equivalents at end of period	START + net in/decrease

Tips	<ul style="list-style-type: none"> • Interest paid will either be within operating or financing activities depending on if it is for a current liability (operating) or a non-current liability (financing). • Interest received only belongs in the investing activities section based on AASB 107. I.e. Interest received from current and non-current both belong in the investing activities section. • Each NCA purchased or sold should have its own corresponding entry. • Dividends paid may also be classified as cash flows from operating activities. • Some of the wording in the above may vary slightly during exam questions. Read the exam question carefully and use wording for the entries that matches the wording of these entries in the question.
-------------	---

Example

To prepare a SCF under normal circumstances an income statement is required as well as the balance sheet for two years. These financial statements then require reconstruction of accounts to find the cash flows that have taken place. Once the cash flows have been found using reconstructed accounts, the SCF can be prepared.

In this example, a series of financial information is provided which will then be used to produce a statement of cash flows. Reconstructions are introduced in the following section. After practicing calculating reconstructions there is practice preparing SCF's using information obtained through reconstructions.

This example prepares all common SCF entries, however, many SCF exam problems will only require a portion of these entries.

The following financial information has been provided by B Company Ltd for the year ended 30 June 2023.

Cash flows from operating activities:

- Cash received from customers was \$80,000.
- A dividend of \$1,200 was received.
- Electricity paid for was \$4,000.
- Wages paid for was \$5,000.
- Advertising paid for was \$7,000.
- Insurance paid for was \$1,800.
- Inventory paid for was \$20,000.
- Interest paid on bank overdraft was \$500.
- Income tax paid was \$5,000.

Cash flows from investing activities:

- Investments were sold for \$15,000 cash.
- Interest received on a term-deposit was \$3,300.
- Machinery was sold for \$18,000 cash.
- New machinery was purchased for \$45,000 cash.
- A motor vehicle was purchased for \$8,000 cash.
- New investments were purchased for \$22,000 cash.

Cash flows from financing activities:

- A 5 year loan of \$40,000 was taken out.
- Share capital worth \$25,000 was issued.
- Debentures of \$5,000 were issued.
- \$6,000 of a loan was repaid.
- \$1,000 of debentures was repaid.
- Interest on a long term loan of \$800 was paid.
- Dividends of \$3,000 were paid.
- The share issue costs were \$2,000.

The cash and cash equivalents at the start of the period was \$23,500.

Required task:

Prepare a Statement of Cash Flows for B3 Company Ltd for the year ended 30 June 2023.

Solution

Step 1 – Cash flows from operating activities:

Cash flows from operating activities is made up of the following sections.

- Receipts from customers.
- Dividend received.
- Payments to suppliers and employees.
- Interest paid (if for current liability).
- Income tax paid.

Receipts from customers.

- Cash received from customers was \$80,000.

Payments to suppliers and employees.

Payments to suppliers and employees is a single entry that is made up of several various payments to suppliers and employees.

Electricity paid for	(4,000)
Wages paid for	(5,000)
Advertising paid for	(7,000)
Insurance paid for	(1,800)
Inventory paid for	(20,000)
Total payments to suppliers and employees	(\$37,800)

Note: Only some suppliers and employees' payments have been included here. There are many varied entries that may be relevant to payments to suppliers and employees.

Interest paid.

- Interest paid on bank overdraft was (\$500).

Note: Interest paid will either be within operating or financing activities depending on if it is for a current liability (operating) or a non-current liability (financing)

Income tax paid.

- Income tax paid was \$5,000.

The figures found above can now be used to prepare the cash flows from operating activities section of the SCF.

Cash flows from operating activities	
Receipts from customers	80,000
Payments to suppliers and employees	(37,800)
Interest paid (if for current liability)	(500)
Income tax paid	(5,000)
Net cash from operating activities	36,700

Step 2 – Cash flows from investing activities.

Cash flows from investing activities is made up of the following sections.

- Proceeds of sale of investments.
- Interest received.
- Proceeds on sale of plant and equipment.
- Payment for NCA's / Purchase of NCA's.
- Payment for Investments.

Proceeds on sale of investments.

- Investments were sold for \$15,000 cash.

Dividend received.

- A dividend of \$1,200 was received from an investment.

Interest received.

- Interest received on a term-deposit was \$3,300.

Proceeds of sale of machinery.

- Machinery was sold for \$18,000 cash.

Note: Each NCA sold should have its own corresponding entry.

Payment for machinery.

- New machinery was purchased for \$45,000 cash.
- A motor vehicle was purchased for \$8,000 cash.

Note: Each NCA purchased should have its own corresponding entry.

Payment for investments.

- New investments were purchased for \$22,000 cash.

Cash flows from investing activities	
Proceeds of sale of investments	15,000
Interest received	3,300
Dividend received	1,200
Proceeds of sale of machinery	18,000
Payment for machinery	(45,000)
Payment for motor vehicle	(8,000)
Payment for investments	(22,000)
Net cash from investing activities	(37,500)

This space has been left blank intentionally so that the next step can fit on one page.

Step 3 – Cash flows from financing activities.

Cash flows from financing activities is made up of the following sections.

- Proceeds from borrowings / loan.
- Share capital proceeds / Additional share capital.
- Debentures issued.
- Repayment of borrowings / loan / debentures.
- Repayment of debentures.
- Interest paid (if for non-current liability).
- Dividends paid.
- Share issue costs.

Proceeds from loan.

- A 5 year loan of \$40,000 was taken out.

Share capital proceeds / Additional share capital.

- Share capital worth \$25,000 was issued.

Debentures issued.

- Debentures of \$5,000 were issued.

Repayment of loan.

- \$6,000 of a loan was repaid.

Repayment of debentures.

- \$1,000 of debentures was repaid.

Interest paid (if for non-current liability).

- Interest on a long term loan of \$800 was paid.

Dividends paid.

- Dividends of \$3,000 were paid.
- Note: Dividends paid may also be classified as cash flows from operating activities as per AASB 107 (Section 34).

Share issue costs.

- The share issue costs were \$2,000.

Cash flows from financing activities	
Proceeds from borrowings	40,000
Share capital proceeds	25,000
Debentures issued	5,000
Repayment of borrowings / loan / debentures	(6,000)
Repayment of debentures	(1,000)
Interest paid (if for non-current liability)	(800)
Dividends paid	(3,000)
Share issue costs	(2,000)
Net cash from financing activities	57,200

Step 4 – Preparation of a Statement of Cash Flows.

The three Statement of Cash Flows sections prepared in previous steps can be collated. At the bottom of the SCF the following is included:

- Net increase/decrease in cash held:
 - Calculated by adding together the cash flows from the three sections.
- Cash and cash equivalents at start of period:
 - Provided in the question.
- Cash and cash equivalents at end of period:
 - Calculated by adding the net increase/decrease in cash held to the cash and cash equivalents at start of period.

B Company Ltd	
Statement of Cash Flows	
for the year ended 30 June 2023	
Cash flows from operating activities	
Receipts from customers	80,000
Payments to suppliers and employees	(37,800)
Interest paid (if for current liability)	(500)
Income tax paid	(5,000)
Net cash from operating activities	36,700
Cash flows from investing activities	
Interest received	3,300
Proceeds of sale of investments	15,000
Dividend received	1,200
Proceeds of sale of machinery	18,000
Payment for Investments	(22,000)
Payment for machinery	(45,000)
Payment for motor vehicle	(8,000)
Net cash from investing activities	(37,500)
Cash flows from financing activities	
Proceeds from borrowings	40,000
Share capital proceeds	25,000
Debentures issued	5,000
Repayment of borrowings / loan	(6,000)
Repayment of debentures	(1,000)
Interest paid (if for non-current liability)	(800)
Dividends paid	(3,000)
Share issue costs	(2,000)
Net cash from financing activities	57,200
Net increase/decrease in cash held	56,400
Cash and cash equivalents at start of period	23,500
Cash and cash equivalents at end of period	79,900

Practice Questions

Questions 1-11: Preparation and Interpretation of a Statement of Cash Flows without reconstructions.

- Questions 1-2: Interpretation of a Statement of Cash Flows.
- Questions 3-4: Calculation of cash and cash equivalents.
- Questions 5-7: Preparation of a Statement of Cash Flows – Operating Activities.
- Questions 8-10: Preparation of a Statement of Cash Flows – Investing Activities.
- Questions 11-13: Preparation of a Statement of Cash Flows – Financing Activities.

Tip Course Guide

While completing this chapter you may find it useful to refer to the relevant chapter in the Essential Insight Course Guide. The Course Guide summarizes all theory relevant for each practical guide chapter. This saves time flipping through multiple pages in the Practical Guide while revising. The Course Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

a. Describe the nature of the Statement of Cash Flows.

b. Describe the benefit to users of financial information of the Statement of Cash Flows being prepared.

Question 2

a. Describe the nature of cash and provide examples.

b. Describe the nature of cash and cash equivalents and provide examples.

Question 3

Using the information below calculate the cash and cash equivalents at the start and end of 2056.

Trial balance (Extract)		
As at 30 June 2056		
	2055	2056
Cash at bank	7,000	5,000
Term deposit (2 months to maturity)	0	16,000
Accounts receivable	18,000	21,000
Bank bills	400	500
Investment	6,000	2,000
Money market deposits	2,500	1,600
Bank loan	13,000	14,000

Workings

Question 4

Using the information below calculate the cash and cash equivalents at the start and end of 2037.

Trial balance (Extract) As at 30 June 2037		
	2037	2036
Bank overdraft	100	0
Shares	23,000	23,000
Accounts payable	1,200	1,800
Bank bills	900	800
Demand deposit	500	500
Commercial bills	1,900	1,600
Petty cash	58	102
Debentures	4,000	6,000

Workings

Question 5

a. Describe the nature of cash flows from operating activities.

b. Provide examples of cash flows from operating activities.

Question 6

The following financial information has been provided by a business for the most recent financial year.

- Cash received from customers was \$52,000.
- Interest on a 10-year mortgage was paid totalling \$5,400.
- Inventory paid for was \$22,000.
- Electricity paid for was \$1,900.
- Wages paid for was \$6,000.
- Income tax paid was \$2,800.
- Rent paid for was \$3,800.

Required task:

a. Prepare the cash flows from operating activities section of the Statement of Cash Flows.

Electricity paid for	
Wages paid for	
Rent paid for	
Inventory paid for	
Total payments to suppliers and employees	

Cash flows from operating activities	
Receipts from customers	
Payments to suppliers and employees	
Income tax paid	
Net cash from operating activities	

Question 7

The following financial information has been provided by a business for the most recent financial year.

- Cash received from customers was \$155,000.
- Income tax paid for the year was \$32,000.
- Interest on bank overdraft paid was \$180.
- A dividend of \$3,000 was received from investments worth \$120,000.
- Inventory paid for during the previous year was \$96,000.
- Wages paid for was \$21,000.
- Rent paid for was \$13,000.
- Insurance paid for was \$2,000.

Required task:

a. Prepare the cash flows from operating activities section of the Statement of Cash Flows.

Total payments to suppliers and employees	

Cash flows from operating activities	

Question 8

a. Describe the nature of cash flows from investing activities.

b. Provide examples of cash flows from investing activities.

Question 9

The following financial information has been provided by a business for the most recent financial year.

- Machinery was purchased for \$12,000 cash.
- A motor vehicle was purchased for \$27,000 and paid for with cash.
- A motor vehicle was sold for \$5,000 cash.
- Investments were sold worth \$24,000.
- Interest was received on a term deposit totalling \$300.

Required task:

a. Prepare the cash flows from investing activities section of the Statement of Cash Flows.

Cash flows from investing activities	
Proceeds of sale of investments	
Interest received	
Proceeds of sale of machinery	
Payment for machinery	
Payment for motor vehicle	
Net cash from investing activities	

Question 10

The following financial information has been provided by a business for the most recent financial year.

- Shares in a company were purchased worth 40,000.
- Office equipment was purchased for \$10,000.
- Office equipment was sold for \$3,000.
- Interest received was \$900.

Required task:

a. Prepare the cash flows from investing activities section of the Statement of Cash Flows.

Cash flows from investing activities	

Question 11

a. Describe the nature of cash flows from financing activities.

b. Provide examples of cash flows from financing activities.

Question 12

The following financial information has been provided by a business for the most recent financial year.

- A mortgage was acquired for \$150,000 to help purchase land worth \$180,000.
- Share capital was issued to raise \$300,000.
- The share issue costs were \$2,400.
- Interest paid on the mortgage was \$2,100.
- Principal of the mortgage repaid was \$4,000.
- A dividend was paid to shareholders worth \$15,000.

Required task:

a. Prepare the cash flows from financing activities section of the Statement of Cash Flows.

Cash flows from financing activities	
Proceeds from borrowings	
Share capital proceeds	
Repayment of borrowings	
Interest paid (if for non-current liability)	
Dividends paid	
Share issue costs	
Net cash from financing activities	

Question 13

The following financial information has been provided by a business for the most recent financial year.

- Debentures were issued values at \$80,000.
- Debentures repaid during the year was \$1,500.
- A 5 year loan was repaid. \$4,000 of payments were for interest and \$6,000 was principal repayments.
- Dividends of \$12,000 were paid to existing shareholders.

Required task:

a. Prepare the cash flows from financing activities section of the Statement of Cash Flows.

Cash flows from financing activities	

Other Theory – Statement of Cash Flows

Differences between the statement comprehensive income and statement of cash flows

Exam tip: This could be asked as:

- Describe why net cash flow from operating activities and total comprehensive income can be different.
- Describe items dealt with differently by statement of comprehensive income and cash flows.
- Describe why the cash balance at the end of financial year is not a reliable indicator of profitability.
- Describe why net operating cash flows can be different from profit after tax.

Notes for table below:

- The first three rows give a general/core answer. The following rows give more specific examples.
- Use the number of marks in a question as a guide to your response level of detail.
- If given a specific case study, refer to items on financial statements with \$ figures.

Financial statement		Comprehensive Income	Cash Flows
		Entry recognized in statement when	
Core understanding	Accrual or cash accounting	Accrual.	Cash.
	Income / Sales revenue	Income / revenue earned.	As cash from income / revenue received (not including creditors who have not paid).
	Expenses	Expenses incurred and expenses paid.	Expenses paid.
Additional entry examples	Depreciation, profits or gain/loss of non-current assets	Recognized as an expense.	Not recognized at all. This is a non-cash expense or loss.
	Doubtful debts / Bad debts	Recognized as an expense.	Not recognized at all. This is a non-cash expense or loss.
	Cost of inventory	Inventory is acquired and sold.	Inventory purchased on credit that is actually paid for.
	Interest revenue	Interest receivable and received.	Interest received only.
	Interest expense	Interest paid and interest payable.	Interest paid only.
	Dividend revenue	Dividend receivable and received.	Dividends received only.
	Unearned Income	Not included in income figure affecting profit. Only shows income earned.	Unearned Income.
	Prepaid expenses	Not included in expenses amount. Only shows expenses incurred.	Prepaid expenses.
	Tax	Tax expense.	Taxes paid.
Asset revaluation	Recognized as other comprehensive income.	Not recognized as it does not involve a cash flow.	

Cash flow problems occurring in a profitable businesses

Cash flow problems may occur in profitable business	
Reasons	<ul style="list-style-type: none">• Profit does not equal cash available e.g., payment for a non-current asset may reduce available cash but increase profit.• There are several cash based entries that do not directly impact profit. E.g., excessive dividends, drawings, purchase of NCAs etc.• Accounts receivable increases revenue/profit but do not have cash flow (yet).• Accounts receivable may not be being managed effectively.• NCAs may be purchased with current liabilities (instead these should be purchased with noncurrent liabilities). This is not related to profit but impacts cash available.• Slow stock turnover reduces cash inflow; however, cash outflow may be present to repay creditors whom inventory was purchased from. This is not related to profit.
Recommendations	<ul style="list-style-type: none">• Internal control strategies for issue areas. E.g., Management of debtors if there are issues with accounts receivable.• Management responses should be prepared alongside budgets and performance reports. E.g., cash budgets, stock and debtors.

Note: If asked this question related to a specific case study – give example reasons and recommendations that align with the case study.

Practice Questions

Questions 14-24: Cash Flows theory review.

Tip

Course Guide

When completing the theory review you may find it useful to refer to the relevant chapter in the Essential Insight Course Guide. The Course Guide summarizes all theory relevant for each practical guide chapter. This saves time flipping through multiple pages in the Practical Guide while revising. The Course Guide can be found by navigating to the Resource Hub link on the front page.

Question 14

Identify which of the following is not a purpose of the Statement of cash flows.

- Enhances the comparison of profitability and net cash flows.
- Enhances the comparison of the efficiency of non-current assets.
- Evaluates the ability of a business to generate cash flows.
- Evaluates the ability of a business to pay debts.

Question 15

Which of the following is not an example of cash and cash equivalents.

- Accounts receivable.
- Bank bills.
- Cash on hand.
- Demand deposit.

Question 16

Cash flow from financing activities include:

- Payment for non-current assets.
- Income tax paid.
- Additional share capital.
- Dividend received.

Question 17

Which of the following is not an entry recognized in the cash flow statement.

- a. Unearned income.
- b. Gain on sale of non-current asset.
- c. Prepaid expenses.
- d. Interest received.

Question 18

Cash flows from investing activities do not include:

- a. Interest received.
- b. Purchase of non-current assets.
- c. Proceeds of sale of plant and equipment.
- d. Dividends paid.

Question 19

Identify which of the following is not a cash flow problem that may occur in a profitable business.

- a. Profit does not equal cash e.g., non-current asset payment.
- b. Breakdown of non-current asset causes insufficient inventory.
- c. Accounts receivable may not be being managed effectively.
- d. Slow stock turnover reduces cash inflow; however, cash outflow may be present to repay creditors.
This is not related to profit.

Question 20

Describe the nature of cash and cash equivalents with examples.

Question 21

Outline the nature of the Statement of cash flows and describe four benefits of this statement.

Reconstructions

Reconstructions use information found in the income statement and balance sheet to reconstruct general ledgers. These general ledger reconstructions are required to find cash inflows or cash outflows that have taken place.

Reconstructions in this chapter:

- Accounts Receivable and Allowance for Doubtful Debts.
- Inventory and Accounts Payable.
- Retained Earnings.
- Prepaid Expense.
- Accrued Expense.
- Accrued Income.
- Sale and Purchase of Non-Current Assets.
- Hidden cash expenses relating to Sale and Purchase of Non-Current Assets.
- Unearned Income / Income Received in Advance.

For each reconstruction the following is demonstrated:

- The purpose of each reconstructed ledger and where the cash flow found appears on the SCF.
- The complete reconstructed ledgers will be shown first, prior to these being broken down step by step.



Sainte-Chapelle, Paris.

Reconstructions – Accounts Receivable and Allowance for Doubtful Debts

When accounts receivable is present in a balance sheet, this reflects that the sales in the income statement have not all been in cash. The accounts receivable ledger account needs to be reconstructed to calculate the cash received from customers. This appears in the SCF by being added to the 'Receipts from Customers' in the 'Cash flows from operating activities' section.

When the balance sheet contains allowance for doubtful debts, this ledger must be reconstructed to calculate the bad debts expense figure. The bad debts expense figure is necessary to reconstruct the accounts receivable ledger.

Example

Big Tings Ltd has provided the following income statement and unclassified balance sheet. Entries relevant to the reconstruction of the accounts receivable and allowance for doubtful debts accounts have been highlighted.

Big Tings Ltd Income Statement For the year ended 30 June 2035		
Sales		80,000
Less sales returns		5,000
Less Cost of Sales		35,000
Gross Profit		40,000
Add Other Income		
Interest	1,000	
Discount received	2,500	
Gain on sale of property, plant and equipment	5,000	
Dividends	3,000	11,500
		51,500
Less Other Expenses		
Interest	1,800	
Advertising	1,000	
Rent	8,000	
Doubtful debts	2,500	
Discount allowed	1,000	
Wages	1,600	
Depreciation of property, plant and equipment	4,000	19,900
Profit before Tax		31,600
Less Income tax expense		9,480
Profit after tax		\$22,120

Additional information:

- Share issue costs were \$4,000.
- Proceeds from the sale of property, plant and equipment was \$12,000.

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Assets		
Cash at Bank	3,000	11,500
Accounts Receivable	3,000	4,000
Allowance for Doubtful Debts	(500)	(400)
Inventory	12,000	15,000
Prepaid rent	5,000	3,000
Accrued interest income	2,000	500
Investments (shares in companies)	20,000	20,000
Property, plant and equipment	50,000	70,000
Less Accumulated Depreciation	(8,000)	(10,000)
Total Assets	86,500	113,600
Liabilities		
Accrued Wages	1,000	1,500
Income Tax Payable	4,000	5,000
Accounts Payable	3,000	5,000
Loan from Bank	0	10,000
Debentures	7,500	4,700
Total Liabilities	15,500	26,200
Equity		
Share Capital	40,000	55,000
General Reserve	16,000	14,400
Retained Earnings	15,000	18,000
Total Liabilities	71,000	87,400
Total Liabilities and Equity	86,500	113,600

Required task:

Calculate the cash received from customers for the year ended 30 June 2035.

Solution

Step 1 – Reconstruction of Allowance for Doubtful Debts.

Allowance for Doubtful Debts					
	Bad Debts	2,600		Opening Balance	500
	Closing Balance	400		Doubtful Debts	2,500
		3,000			3,000

Therefore, the bad debts figure was \$2,600 for the year ended 30 June 2035.

Reconstruction of allowance for doubtful debts account purpose: The bad debts figure calculated when reconstructing the allowance for doubtful debts is needed to reconstruct accounts receivable. The bad debts entry calculated is transferred to the accounts receivable account.

Note: If allowance for doubtful debts is not present on the balance sheet, this reconstruction is not required.

Step 2 – Reconstruction of Accounts Receivable.

Accounts Receivable					
	Opening Balance	3,000		Sales Returns	5,000
	Sales	80,000		Bad Debts	2,600
				Discount Allowed	1,000
				Bank	70,400
				Closing Balance	4,000
		83,000			83,000

Therefore, the cash received from customers was \$70,400 for the year ended 30 June 2035.

Reconstruction of accounts receivable account purpose: The bank figure calculated when reconstructing the accounts receivable account is the cash received from customers. This appears in the SCF is by being added to the "Receipts from Customers" in the 'Cash flows from operating activities' section.

Practice Questions

Questions 25-27: Reconstructions – Accounts Receivable and Allowance for Doubtful Debts.

Tips	<u>Using model workings as a guide</u>
	It is recommended to have the demonstrated example and solution open during the first question for of each of the reconstruction problems. This will serve as a reference so you can work backwards from a solution to find the process needed for the question you are working on. You need to reach a point where you do not need to look at the model answers when completing practice questions. This replicates test conditions. If you still need more practice, potentially re-attempt the questions you have attempted previously once you have attempted all the questions in the problem set. This should help build confidence.

Question 25

Chill Vibes has provided the following income statement and unclassified balance sheet.

Chill Vibes Income Statement For the year ended 30 June 2038		
Sales		700
Less sales returns		30
Less Cost of Sales		250
Gross Profit		420
Add Other Income		
Interest	40	
Discount received	30	
Gain on sale of property, plant and equipment	20	
Dividends	50	140
		560
Less Other Expenses		
Interest	30	
Advertising	9	
Other expenses	1	
Rent	60	
Doubtful debts	20	
Discount allowed	10	
Wages	20	
Depreciation of property, plant and equipment	40	190
Profit before Tax		370
Less Income tax expense		111
Profit after tax		259

Additional information:

- Proceeds from the sale of property, plant and equipment was \$50.
- Purchase returns for the year were \$10.
- Share issue costs during the period were \$1.

Chill Vibes Unclassified Balance Sheets As at 30 June 2038		
	30 June 2037	30 June 2038
Assets		
Cash at Bank	120	160
Accounts Receivable	40	50
Allowance for Doubtful Debts	(30)	(40)
Inventory	60	90
Prepaid rent	70	50
Accrued interest income	40	20
Investments (shares in companies)	150	150
Property, plant and Equipment	140	160
Less Accumulated Depreciation	(70)	(50)
Total Assets	520	590
Liabilities		
Accrued Wages	50	40
Income Tax Payable	10	20
Loan from Bank	0	60
Accounts Payable	20	30
Debentures	110	70
Total Liabilities	190	220
Equity		
Share Capital	150	160
General Reserve	110	90
Retained Earnings	70	120
Total Equity	330	370
Total Liabilities and Equity	520	590

Required tasks:

a. Calculate the cash received from customers for the year ended 30 June 2038.

Allowance for Doubtful Debts				
	Bad Debts			Opening Balance
	Closing Balance			Doubtful Debts

Accounts Receivable				
	Opening Balance			Sales Returns
	Sales			Bad Debts
				Discount Allowed
				Bank
				Closing Balance

b. Describe the purpose of reconstructing the allowance for doubtful debts account.

c. Describe the purpose of reconstructing the accounts receivable account.

Question 26

Lo-Fi Hip Hop Radio Ltd has provided the following income statement and unclassified balance sheet.

Lo-Fi Hip Hop Radio Ltd Income Statement For the year ended 30 June 2043		
Sales		140
Less Cost of Sales		50
Gross Profit		90
Add Other Income		
Interest	5	
Discount received	4	
Dividends	7	16
		106
Less Other Expenses		
Interest	10	
Advertising	4	
Rent	15	
Wages	20	
Other expenses	20	
Depreciation of property, plant and equipment	7	76
Profit before Tax		30
Less Income tax expense		9
Profit after tax		21

Lo-Fi Hip Hop Radio Ltd Unclassified Balance Sheets As at 30 June 2043		
	30 June 2042	30 June 2043
Assets		
Cash at Bank	155	145
Accounts Receivable	40	50
Inventory	30	34
Prepaid advertising	5	6
Accrued interest income	12	8
Investments (shares in companies)	25	25
Property, plant and Equipment	80	90
Less Accumulated Depreciation	(60)	(35)
Total Assets	287	323
Liabilities		
Accrued Interest	8	4
Income Tax Payable	14	19
Accounts Payable	50	40
Debentures	40	35
Total Liabilities	112	98
Equity		
Share Capital	55	87
General Reserve	30	50
Retained Earnings	90	88
Total Equity	175	225
Total Liabilities and Equity	287	323

Additional information:

- Proceeds from the sale of property, plant and equipment was \$20.
- The loss on sale of property, plant and equipment was \$5 (within Other expenses).
- Share issue costs during the period were \$3 (not on income statement as it is a closed account).

Required task:

a. Calculate the cash received from customers for the year ended 30 June 2043.

Accounts Receivable					

Question 27

Vogue Styles has provided the following income statement and unclassified balance sheet.

Vogue Styles Income Statement For the year ended 30 June 2038		
Sales		128
Less sales returns		16
Less Cost of Sales		61
Gross Profit		51
Add Other Income		
Interest	5	
Discount received	2	
Dividends	4	11
		62
Less Other Expenses		
Interest	1	
Insurance	3	
Rent	11	
Doubtful debts	4	
Selling and distribution expense	5	
Loss on sale of machinery	3	
Wages	4	
Depreciation of property, plant and equipment	12	43
Profit before Tax		19
Less Income tax expense		5.7
Profit after tax		13.3

Additional information:

- Proceeds from the machinery was \$15.
- Purchase returns for the year were \$6.
- Share issue costs were \$4.
- The loan from bank is due within 9 months.

Vogue Styles Unclassified Balance Sheets As at 30 June 2038		
	30 June 2038	30 June 2037
Assets		
Cash at Bank	144	148
Accounts Receivable	45	50
Allowance for Doubtful Debts		
Debts	(6)	(5)
Inventory	28	25
Prepaid insurance	5	7
Accrued interest income	6	12
Investments	21	23
Machinery	70	60
Less Accumulated Depreciation	(29)	(40)
Total Assets	284	280
Liabilities		
Accrued selling and distribution expense	8	6
Income Tax Payable	5	3
Loan from Bank	3	0
Accounts Payable	55	60
Accrued wages	2	4
Debentures	18	26
Total Liabilities	91	99
Equity		
Share Capital	76	61
General Reserve	47	40
Retained Earnings	70	80
Total Equity	193	181
Total Liabilities and Equity	284	280

Required task:

a. Calculate the cash received from customers for the year ended 30 June 2038.

Hint: In this question the year 1 and year 2 columns in the balance sheet have been swapped. Make sure to use the correct figure in reconstructions that do this.

Allowance for Doubtful Debts					

Accounts Receivable					

Reconstructions – Inventory and Accounts Payable

When a balance sheet includes accounts payable, it is required to reconstruct the inventory and accounts payable ledgers. These reconstructions calculate the cash that was paid to creditors during the year. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

Example

Big Tings Ltd has provided the following income statement and unclassified balance sheet. Entries relevant to the reconstruction of the inventory and accounts payable accounts have been highlighted.

Big Tings Ltd Income Statement For the year ended 30 June 2035		
Sales		80,000
Less sales returns		5,000
Less Cost of Sales		35,000
Gross Profit		40,000
Add Other Income		
Interest	1,000	
Discount received	2,500	
Gain on sale of property, plant and equipment	5,000	
Dividends	3,000	11,500
		51,500
Less Other Expenses		
Interest	1,800	
Advertising	1,000	
Rent	8,000	
Doubtful debts	2,500	
Discount allowed	1,000	
Wages	1,600	
Depreciation of property, plant and equipment	4,000	19,900
Profit before Tax		31,600
Less Income tax expense		9,480
Profit after tax		\$22,120

Additional information:

- Share issue costs were \$4,000.
- Proceeds from the sale of property, plant and equipment was \$12,000.

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Assets		
Cash at Bank	3,000	11,500
Accounts Receivable	3,000	4,000
Allowance for Doubtful Debts	(500)	(400)
Inventory	12,000	15,000
Prepaid rent	5,000	3,000
Accrued interest income	2,000	500
Investments (shares in companies)	20,000	20,000
Property, plant and equipment	50,000	70,000
Less Accumulated Depreciation	(8,000)	(10,000)
Total Assets	86,500	113,600
Liabilities		
Accrued Wages	1,000	1,500
Income Tax Payable	4,000	5,000
Accounts Payable	3,000	5,000
Loan from Bank	0	10,000
Debentures	7,500	4,700
Total Liabilities	15,500	26,200
Equity		
Share Capital	40,000	55,000
General Reserve	16,000	14,400
Retained Earnings	15,000	18,000
Total Liabilities	71,000	87,400
Total Liabilities and Equity	86,500	113,600

Required task:

Calculate the cash that was paid to creditors for the year ended 30 June 2035.

Solution

Step 1 – Reconstruction of Inventory.

Inventory					
	Opening Balance	12,000		Cost of Sales	35,000
	Accounts Payable	39,000		Purchases	1,000
				Returns	
				Closing Balance	15,000
		51,000			51,000

Reconstruction of Inventory account purpose: The accounts payable that is calculated when reconstructing the inventory account is the amount of inventory purchased on credit which is necessary to reconstruct accounts payable. The accounts payable entry that is calculated is transferred to the accounts payable account.

Step 2 – Reconstruction of Accounts Payable.

Accounts Payable					
	Discount Received	2,500		Opening Balance	3,000
	Purchases Returns	1,000		Inventory	39,000
	Bank	33,500			
	Closing Balance	5,000			
		42,000			42,000

Therefore, the cash paid to creditors was \$33,500 for the year ended 30 June 2035.

Reconstruction of Accounts Payable account purpose: The bank figure calculated when reconstructing the accounts payable account is the cash paid to creditors. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

Practice Questions

Questions 28-30: Reconstructions – Inventory and Accounts Payable.

Question 28

Chill Vibes has provided the following income statement and unclassified balance sheet.

Chill Vibes Income Statement For the year ended 30 June 2038		
Sales		700
Less sales returns		30
Less Cost of Sales		250
Gross Profit		420
Add Other Income		
Interest	40	
Discount received	30	
Gain on sale of property, plant and equipment	20	
Dividends	50	140
		560
Less Other Expenses		
Interest	30	
Advertising	9	
Other expenses	1	
Rent	60	
Doubtful debts	20	
Discount allowed	10	
Wages	20	
Depreciation of property, plant and equipment	40	190
Profit before Tax		370
Less Income tax expense		111
Profit after tax		259

Additional information:

- Proceeds from the sale of property, plant and equipment was \$50.
- Purchase returns for the year were \$10.
- Share issue costs during the period were \$1.

Chill Vibes Unclassified Balance Sheets As at 30 June 2038		
	30 June 2037	30 June 2038
Assets		
Cash at Bank	120	160
Accounts Receivable	40	50
Allowance for Doubtful Debts	(30)	(40)
Inventory	60	90
Prepaid rent	70	50
Accrued interest income	40	20
Investments (shares in companies)	150	150
Property, plant and Equipment	140	160
Less Accumulated Depreciation	(70)	(50)
Total Assets	520	590
Liabilities		
Accrued Wages	50	40
Income Tax Payable	10	20
Loan from Bank	0	60
Accounts Payable	20	30
Debentures	110	70
Total Liabilities	190	220
Equity		
Share Capital	150	160
General Reserve	110	90
Retained Earnings	70	120
Total Equity	330	370
Total Liabilities and Equity	520	590

Required task:

a. Calculate the cash paid for the purchase of inventory for the year ended 30 June 2038.

Inventory					
	Opening Balance			Cost of Sales	
	Accounts Payable			Purchases	
				Returns	
				Closing Balance	

Accounts Payable					
	Discount Received			Opening Balance	
	Purchases Returns			Inventory	
	Bank				
	Closing Balance				

b. Describe the purpose of reconstructing the inventory account.

c. Describe the purpose of reconstructing the accounts payable account.

Question 29

Lo-Fi Hip Hop Radio Ltd has provided the following income statement and unclassified balance sheet.

Lo-Fi Hip Hop Radio Ltd Income Statement For the year ended 30 June 2043		
Sales		140
Less Cost of Sales		50
Gross Profit		90
Add Other Income		
Interest	5	
Discount received	4	
Dividends	7	16
		106
Less Other Expenses		
Interest	10	
Advertising	4	
Rent	15	
Wages	20	
Other expenses	20	
Depreciation of property, plant and equipment	7	76
Profit before Tax		30
Less Income tax expense		9
Profit after tax		21

Lo-Fi Hip Hop Radio Ltd Unclassified Balance Sheets As at 30 June 2043		
	30 June 2042	30 June 2043
Assets		
Cash at Bank	155	145
Accounts Receivable	40	50
Inventory	30	34
Prepaid advertising	5	6
Accrued interest income	12	8
Investments (shares in companies)	25	25
Property, plant and Equipment	80	90
Less Accumulated Depreciation	(60)	(35)
Total Assets	287	323
Liabilities		
Accrued Interest	8	4
Income Tax Payable	14	19
Accounts Payable	50	40
Debentures	40	35
Total Liabilities	112	98
Equity		
Share Capital	55	87
General Reserve	30	50
Retained Earnings	90	88
Total Equity	175	225
Total Liabilities and Equity	287	323

Additional information:

- Proceeds from the sale of property, plant and equipment was \$20.
- The loss on sale of property, plant and equipment was \$5 (within Other expenses).
- Share issue costs during the period were \$3 (not on income statement as it is a closed account).

Required task:

a. Calculate the cash paid for the purchase of inventory for the year ended 30 June 2043.

Inventory					

Accounts Payable					

Question 30

Vogue Styles has provided the following income statement and unclassified balance sheet.

Vogue Styles Income Statement For the year ended 30 June 2038		
Sales		128
Less sales returns		16
Less Cost of Sales		61
Gross Profit		51
Add Other Income		
Interest	5	
Discount received	2	
Dividends	4	11
		62
Less Other Expenses		
Interest	1	
Insurance	3	
Rent	11	
Doubtful debts	4	
Selling and distribution expense	5	
Loss on sale of machinery	3	
Wages	4	
Depreciation of property, plant and equipment	12	43
Profit before Tax		19
Less Income tax expense		5.7
Profit after tax		13.3

Additional information:

- Proceeds from the machinery was \$15.
- Purchase returns for the year were \$6.
- Share issue costs were \$4.
- The loan from bank is due within 9 months.

Vogue Styles Unclassified Balance Sheets As at 30 June 2038		
	30 June 2038	30 June 2037
Assets		
Cash at Bank	144	148
Accounts Receivable	45	50
Allowance for Doubtful Debts	(6)	(5)
Inventory	28	25
Prepaid insurance	5	7
Accrued interest income	6	12
Investments	21	23
Machinery	70	60
Less Accumulated Depreciation	(29)	(40)
Total Assets	284	280
Liabilities		
Accrued selling and distribution expense	8	6
Income Tax Payable	5	3
Loan from Bank	3	0
Accounts Payable	55	60
Accrued wages	2	4
Debentures	18	26
Total Liabilities	91	99
Equity		
Share Capital	76	61
General Reserve	47	40
Retained Earnings	70	80
Total Equity	193	181
Total Liabilities and Equity	284	280

Required task:

a. Calculate the cash paid for the purchase of inventory for the year ended 30 June 2038.

Inventory					

Accounts Payable					

Reconstructions – Income Tax Payable

It is necessary to reconstruct the income tax payable account to find the income tax paid in a year. This appears in the SCF as 'Income Tax Paid' in the 'Cash flows from operating activities' section.

It is incorrect to assume that the income tax paid in Year 2 is the Income Tax payable in Year 1. There have historically been SCSA exam questions that require calculation of income tax paid. An example is the 2019 ATAR exam, question 19.

Example

Big Tings Ltd has provided the following income statement and unclassified balance sheet. Entries relevant to the reconstruction of the income tax payable account have been highlighted.

Big Tings Ltd Income Statement For the year ended 30 June 2035		
Sales		80,000
Less sales returns		5,000
Less Cost of Sales		35,000
Gross Profit		40,000
Add Other Income		
Interest	1,000	
Discount received	2,500	
Gain on sale of property, plant and equipment	5,000	
Dividends	3,000	11,500
		51,500
Less Other Expenses		
Interest	1,800	
Advertising	1,000	
Rent	8,000	
Doubtful debts	2,500	
Discount allowed	1,000	
Wages	1,600	
Depreciation of property, plant and equipment	4,000	19,900
Profit before Tax		31,600
Less Income tax expense		9,480
Profit after tax		\$22,120

Additional information:

- Share issue costs were \$4,000.
- Proceeds from the sale of property, plant and equipment was \$12,000.

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Assets		
Cash at Bank	3,000	11,500
Accounts Receivable	3,000	4,000
Allowance for Doubtful Debts	(500)	(400)
Inventory	12,000	15,000
Prepaid rent	5,000	3,000
Accrued interest income	2,000	500
Investments (shares in companies)	20,000	20,000
Property, plant and equipment	50,000	70,000
Less Accumulated Depreciation	(8,000)	(10,000)
Total Assets	86,500	113,600
Liabilities		
Accrued Wages	1,000	1,500
Income Tax Payable	4,000	5,000
Accounts Payable	3,000	5,000
Loan from Bank	0	10,000
Debentures	7,500	4,700
Total Liabilities	15,500	26,200
Equity		
Share Capital	40,000	55,000
General Reserve	16,000	14,400
Retained Earnings	15,000	18,000
Total Liabilities	71,000	87,400
Total Liabilities and Equity	86,500	113,600

Required task:

Calculate the income tax that was paid for the year ended 30 June 2035.

Solution

Step 1 – Reconstruction of Tax Payable.

Income Tax Payable					
	Bank	8,480		Opening Balance	4,000
	Closing Balance	5,000		Income tax expense	9,480
		13,480			13,480

Therefore, the income tax paid was \$8,480 for the year ended 30 June 2035.

Reconstruction of Tax Payable account purpose: The bank figure calculated when reconstructing the income tax payable account is the income tax paid. This appears in the SCF as 'Income Tax Paid' in the 'Cash flows from operating activities' section.

Practice Questions

Questions 31-33: Reconstructions – Income Tax Payable.

Tip	<u>Similar Layout to Previous Reconstruction</u>
	It may help to remember that the layout of this account is similar to the accounts payable account given the name of the accounts is similar. They are similar in the sense of the location of the opening balance, closing balance and bank figures. Rather than the inventory entry, there is an income tax expense entry instead.



Miradouro da Graça, Lisbon.

Question 31

Chill Vibes has provided the following income statement and unclassified balance sheet.

Chill Vibes Income Statement For the year ended 30 June 2038		
Sales		700
Less sales returns		30
Less Cost of Sales		250
Gross Profit		420
Add Other Income		
Interest	40	
Discount received	30	
Gain on sale of property, plant and equipment	20	
Dividends	50	140
		560
Less Other Expenses		
Interest	30	
Advertising	9	
Other expenses	1	
Rent	60	
Doubtful debts	20	
Discount allowed	10	
Wages	20	
Depreciation of property, plant and equipment	40	190
Profit before Tax		370
Less Income tax expense		111
Profit after tax		259

Additional information:

- Proceeds from the sale of property, plant and equipment was \$50.
- Purchase returns for the year were \$10.
- Share issue costs during the period were \$1.

Chill Vibes Unclassified Balance Sheets As at 30 June 2038		
	30 June 2037	30 June 2038
Assets		
Cash at Bank	120	160
Accounts Receivable	40	50
Allowance for Doubtful Debts	(30)	(40)
Inventory	60	90
Prepaid rent	70	50
Accrued interest income	40	20
Investments (shares in companies)	150	150
Property, plant and Equipment	140	160
Less Accumulated Depreciation	(70)	(50)
Total Assets	520	590
Liabilities		
Accrued Wages	50	40
Income Tax Payable	10	20
Loan from Bank	0	60
Accounts Payable	20	30
Debentures	110	70
Total Liabilities	190	220
Equity		
Share Capital	150	160
General Reserve	110	90
Retained Earnings	70	120
Total Equity	330	370
Total Liabilities and Equity	520	590

Required tasks:

a. Calculate the income tax paid for the year ended 30 June 2038.

Income Tax Payable				
	Bank			Opening Balance
	Closing Balance			Income tax expense

b. Describe the purpose of reconstructing the income tax payable account.

Question 32

Lo-Fi Hip Hop Radio Ltd has provided the following income statement and unclassified balance sheet.

Lo-Fi Hip Hop Radio Ltd Income Statement For the year ended 30 June 2043		
Sales		140
Less Cost of Sales		50
Gross Profit		90
Add Other Income		
Interest	5	
Discount received	4	
Dividends	7	16
		106
Less Other Expenses		
Interest	10	
Advertising	4	
Rent	15	
Wages	20	
Other expenses	20	
Depreciation of property, plant and equipment	7	76
Profit before Tax		30
Less Income tax expense		9
Profit after tax		21

Lo-Fi Hip Hop Radio Ltd Unclassified Balance Sheets As at 30 June 2043		
	30 June 2042	30 June 2043
Assets		
Cash at Bank	155	145
Accounts Receivable	40	50
Inventory	30	34
Prepaid advertising	5	6
Accrued interest income	12	8
Investments (shares in companies)	25	25
Property, plant and Equipment	80	90
Less Accumulated Depreciation	(60)	(35)
Total Assets	287	323
Liabilities		
Accrued Interest	8	4
Income Tax Payable	14	19
Accounts Payable	50	40
Debentures	40	35
Total Liabilities	112	98
Equity		
Share Capital	55	87
General Reserve	30	50
Retained Earnings	90	88
Total Equity	175	225
Total Liabilities and Equity	287	323

Additional information:

- Proceeds from the sale of property, plant and equipment was \$20.
- The loss on sale of property, plant and equipment was \$5 (within Other expenses).
- Share issue costs during the period were \$3 (not on income statement as it is a closed account).

Required task:

a. Calculate the income tax paid for the year ended 30 June 2043.

Income Tax Payable					

Question 33

Vogue Styles has provided the following income statement and unclassified balance sheet.

Vogue Styles Income Statement For the year ended 30 June 2038		
Sales		128
Less sales returns		16
Less Cost of Sales		61
Gross Profit		51
Add Other Income		
Interest	5	
Discount received	2	
Dividends	4	11
		62
Less Other Expenses		
Interest	1	
Insurance	3	
Rent	11	
Doubtful debts	4	
Selling and distribution expense	5	
Loss on sale of machinery	3	
Wages	4	
Depreciation of property, plant and equipment	12	43
Profit before Tax		19
Less Income tax expense		5.7
Profit after tax		13.3

Additional information:

- Proceeds from the machinery was \$15.
- Purchase returns for the year were \$6.
- Share issue costs were \$4.
- The loan from bank is due within 9 months.

Vogue Styles Unclassified Balance Sheets As at 30 June 2038		
	30 June 2038	30 June 2037
Assets		
Cash at Bank	144	148
Accounts Receivable	45	50
Allowance for Doubtful Debts	(6)	(5)
Inventory	28	25
Prepaid insurance	5	7
Accrued interest income	6	12
Investments	21	23
Machinery	70	60
Less Accumulated Depreciation	(29)	(40)
Total Assets	284	280
Liabilities		
Accrued selling and distribution expense	8	6
Income Tax Payable	5	3
Loan from Bank	3	0
Accounts Payable	55	60
Accrued wages	2	4
Debentures	18	26
Total Liabilities	91	99
Equity		
Share Capital	76	61
General Reserve	47	40
Retained Earnings	70	80
Total Equity	193	181
Total Liabilities and Equity	284	280

Required task:

a. Calculate the income tax paid for the year ended 30 June 2038.

Income Tax Payable					

Reconstructions – Retained Earnings

The dividend paid can be found by reconstructing the retained earnings ledger account. This appears on the SCF as 'Dividend paid' in the 'Cash flows from financing activities' section.

Example

Big Tings Ltd has provided the following income statement and unclassified balance sheet. Entries relevant to the reconstruction of the retained earnings account have been highlighted.

Big Tings Ltd Income Statement For the year ended 30 June 2035		
Sales		80,000
Less sales returns		5,000
Less Cost of Sales		35,000
Gross Profit		40,000
Add Other Income		
Interest	1,000	
Discount received	2,500	
Gain on sale of property, plant and equipment	5,000	
Dividends	3,000	11,500
		51,500
Less Other Expenses		
Interest	1,800	
Advertising	1,000	
Rent	8,000	
Doubtful debts	2,500	
Discount allowed	1,000	
Wages	1,600	
Depreciation of property, plant and equipment	4,000	19,900
Profit before Tax		31,600
Less Income tax expense		9,480
Profit after tax		\$22,120

Additional information:

- Share issue costs were \$4,000.
- Proceeds from the sale of property, plant and equipment was \$12,000.

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Assets		
Cash at Bank	3,000	11,500
Accounts Receivable	3,000	4,000
Allowance for Doubtful Debts	(500)	(400)
Inventory	12,000	15,000
Prepaid rent	5,000	3,000
Accrued interest income	2,000	500
Investments (shares in companies)	20,000	20,000
Property, plant and equipment	50,000	70,000
Less Accumulated Depreciation	(8,000)	(10,000)
Total Assets	86,500	113,600
Liabilities		
Accrued Wages	1,000	1,500
Income Tax Payable	4,000	5,000
Accounts Payable	3,000	5,000
Loan from Bank	0	10,000
Debentures	7,500	4,700
Total Liabilities	15,500	26,200
Equity		
Share Capital	40,000	55,000
General Reserve	16,000	14,400
Retained Earnings	15,000	18,000
Total Liabilities	71,000	87,400
Total Liabilities and Equity	86,500	113,600

Required task:

Calculate the dividend paid for the year ended 30 June 2035.

Solution

Step 1 – General Reserve increase or decrease.

The General Reserve figure needed to reconstruct the retained earnings account is found by Year 2 subtract Year 1.

- If the result is **positive**
 - This is a transfer of profits **from retained earnings to the general reserve.**
 - Retained earnings is **debited.**
- If the result is **negative**
 - This is a transfer of profits **to retained earnings from the general reserve.**
 - Retained earnings is **credited.**

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Equity		
General Reserve	40,000	55,000

In this example, General Reserve figure = 55,000 – 40,000 = **15,000**. Therefore, the result is debited to retained earnings.

Step 2 – Reconstruction of Retained Earnings.

Retained Earnings					
	Dividend	8,720		Opening Balance	16,000
	Closing Balance	14,400		Profit and Loss	22,120
	General Reserve	15,000			
		38,120			38,120

The Profit and Loss figure is Profit after tax from the income statement.

Therefore, the dividend paid was \$8,720 for the year ended 30 June 2035.

Note: Dividend appeared as an entry on the income statement within 'add other income'. This is the **dividend received**. This will appear separately on the statement of cash flows. The retained earnings reconstruction finds the **dividend paid**.

Reconstruction of Retained Earnings account purpose: The dividend figure found when reconstructing the retained earnings account is the dividend paid. This appears on the SCF as 'Dividend paid' in the 'Cash flows from financing activities' section.

Practice Questions

Questions 34-36: Reconstructions – Retained Earnings.

Question 34

Chill Vibes has provided the following income statement and unclassified balance sheet.

Chill Vibes Income Statement For the year ended 30 June 2038		
Sales		700
Less sales returns		30
Less Cost of Sales		250
Gross Profit		420
Add Other Income		
Interest	40	
Discount received	30	
Gain on sale of property, plant and equipment	20	
Dividends	50	140
		560
Less Other Expenses		
Interest	30	
Advertising	9	
Other expenses	1	
Rent	60	
Doubtful debts	20	
Discount allowed	10	
Wages	20	
Depreciation of property, plant and equipment	40	190
Profit before Tax		370
Less Income tax expense		111
Profit after tax		259

Additional information:

- Proceeds from the sale of property, plant and equipment was \$50.
- Purchase returns for the year were \$10.
- Share issue costs during the period were \$1.

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Assets		
Cash at Bank	3,000	11,500
Accounts Receivable	3,000	4,000
Allowance for Doubtful Debts	(500)	(400)
Inventory	12,000	15,000
Prepaid rent	5,000	3,000
Accrued interest income	2,000	500
Investments (shares in companies)	20,000	20,000
Property, plant and equipment	50,000	70,000
Less Accumulated Depreciation	(8,000)	(10,000)
Total Assets	\$86,500	\$113,600
Liabilities		
Accrued Wages	1,000	1,500
Income Tax Payable	4,000	5,000
Accounts Payable	3,000	5,000
Loan from Bank	0	10,000
Debentures	7,500	4,700
Total Liabilities	15,500	26,200
Equity		
Share Capital	40,000	55,000
General Reserve	16,000	14,400
Retained Earnings	15,000	18,000
Total Liabilities	71,000	87,400
Total Liabilities and Equity	86,500	113,600

Required task:

a. Calculate the dividend paid for the year ended 30 June 2038.

Workings

Retained Earnings					
	Dividend			Opening Balance	
	Closing Balance			Profit and Loss	
				General Reserve	

b. Has a transfer to or from retained earnings from the general reserve taken place?

c. Describe the purpose of reconstructing the retained earnings account.

Question 35

Lo-Fi Hip Hop Radio Ltd has provided the following income statement and unclassified balance sheet.

Lo-Fi Hip Hop Radio Ltd Income Statement For the year ended 30 June 2043		
Sales		140
Less Cost of Sales		50
Gross Profit		90
Add Other Income		
Interest	5	
Discount received	4	
Dividends	7	16
		106
Less Other Expenses		
Interest	10	
Advertising	4	
Rent	15	
Wages	20	
Other expenses	20	
Depreciation of property, plant and equipment	7	76
Profit before Tax		30
Less Income tax expense		9
Profit after tax		21

Lo-Fi Hip Hop Radio Ltd Unclassified Balance Sheets As at 30 June 2043		
	30 June 2042	30 June 2043
Assets		
Cash at Bank	155	145
Accounts Receivable	40	50
Inventory	30	34
Prepaid advertising	5	6
Accrued interest income	12	8
Investments (shares in companies)	25	25
Property, plant and Equipment	80	90
Less Accumulated Depreciation	(60)	(35)
Total Assets	287	323
Liabilities		
Accrued Interest	8	4
Income Tax Payable	14	19
Accounts Payable	50	40
Debentures	40	35
Total Liabilities	112	98
Equity		
Share Capital	55	87
General Reserve	30	50
Retained Earnings	90	88
Total Equity	175	225
Total Liabilities and Equity	287	323

Additional information:

- Proceeds from the sale of property, plant and equipment was \$20.
- The loss on sale of property, plant and equipment was \$5 (within Other expenses).
- Share issue costs during the period were \$3 (not on income statement as it is a closed account).

Required task:

a. Calculate the dividend paid for the year ended 30 June 2043.

Workings

Retained Earnings					

Question 36

Vogue Styles has provided the following income statement and unclassified balance sheet.

Vogue Styles Income Statement For the year ended 30 June 2038		
Sales		128
Less sales returns		16
Less Cost of Sales		61
Gross Profit		51
Add Other Income		
Interest	5	
Discount received	2	
Dividends	4	11
		62
Less Other Expenses		
Interest	1	
Insurance	3	
Rent	11	
Doubtful debts	4	
Selling and distribution expense	5	
Loss on sale of machinery	3	
Wages	4	
Depreciation of property, plant and equipment	12	43
Profit before Tax		19
Less Income tax expense		5.7
Profit after tax		13.3

Additional information:

- Proceeds from the machinery was \$15.
- Purchase returns for the year were \$6.
- Share issue costs were \$4.
- The loan from bank is due within 9 months.

Vogue Styles Unclassified Balance Sheets As at 30 June 2038		
	30 June 2038	30 June 2037
Assets		
Cash at Bank	144	148
Accounts Receivable	45	50
Allowance for Doubtful Debts	(6)	(5)
Inventory	28	25
Prepaid insurance	5	7
Accrued interest income	6	12
Investments	21	23
Machinery	70	60
Less Accumulated Depreciation	(29)	(40)
Total Assets	284	280
Liabilities		
Accrued selling and distribution expense	8	6
Income Tax Payable	5	3
Loan from Bank	3	0
Accounts Payable	55	60
Accrued wages	2	4
Debentures	18	26
Total Liabilities	91	99
Equity		
Share Capital	76	61
General Reserve	47	40
Retained Earnings	70	80
Total Equity	193	181
Total Liabilities and Equity	284	280

Required task:

a. Calculate the dividend paid for the year ended 30 June 2038.

Workings

Retained Earnings					

Reconstructions – Share Capital

The share capital proceeds can be found by reconstructing the share capital ledger account. This appears on the SCF as 'Share capital proceeds in the 'Cash flows from financing activities' section. This reconstruction was required for question 20 of the 2020 ATAR exam. In question 18 of the 2016 ATAR exam, no share issue costs were listed despite an increase in share capital. For this 2016 question the same reconstruction demonstrated in this worked example was not required given there was no share issue costs.

Example

Big Tings Ltd has provided the following income statement and unclassified balance sheet. Entries relevant to the reconstruction of the retained earnings account have been highlighted.

Big Tings Ltd Income Statement For the year ended 30 June 2035		
Sales		80,000
Less sales returns		5,000
Less Cost of Sales		35,000
Gross Profit		40,000
Add Other Income		
Interest	1,000	
Discount received	2,500	
Gain on sale of property, plant and equipment	5,000	
Dividends	3,000	11,500
		51,500
Less Other Expenses		
Interest	1,800	
Advertising	1,000	
Rent	8,000	
Doubtful debts	2,500	
Discount allowed	1,000	
Wages	1,600	
Depreciation of property, plant and equipment	4,000	19,900
Profit before Tax		31,600
Less Income tax expense		9,480
Profit after tax		\$22,120

Additional information:

- Share issue costs were \$4,000.
- Proceeds from the sale of property, plant and equipment was \$12,000.

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Assets		
Cash at Bank	3,000	11,500
Accounts Receivable	3,000	4,000
Allowance for Doubtful Debts	(500)	(400)
Inventory	12,000	15,000
Prepaid rent	5,000	3,000
Accrued interest income	2,000	500
Investments (shares in companies)	20,000	20,000
Property, plant and equipment	50,000	70,000
Less Accumulated Depreciation	(8,000)	(10,000)
Total Assets	86,500	113,600
Liabilities		
Accrued Wages	1,000	1,500
Income Tax Payable	4,000	5,000
Accounts Payable	3,000	5,000
Loan from Bank	0	10,000
Debentures	7,500	4,700
Total Liabilities	15,500	26,200
Equity		
Share Capital	40,000	55,000
General Reserve	16,000	14,400
Retained Earnings	15,000	18,000
Total Liabilities	71,000	87,400
Total Liabilities and Equity	86,500	113,600

Required task:

Calculate the share capital proceeds for the year ended 30 June 2035.

Solution**Step 1 – Reconstruction of Share Capital.**

Share Capital					
	Bank	4,000		Opening Share Capital	40,000
	Closing Share Capital	55,000		Bank	19,000
		59,000			59,000

Therefore, the Share Capital proceeds were \$19,000 for the year ended 30 June 2035.

The share issue costs are provided in the additional information in the question. This is the bank figure on the debit side of \$4,000. This appears in the SCF as 'Share issue costs' in the 'Cash flows from financing activities' section.

Note: Share issue costs does not appear on the income statement in the question as this account is closed during the period as the share issue costs are paid from Cash at Bank. This is why share issue costs were listed in the additional information.

Reconstruction of Share Capital account purpose: The bank figure on the credit side that is calculated when reconstructing the Share capital account is the cash received from the issue of shares. This appears in the SCF as 'Share issue proceeds' in the 'Cash flows from financing activities' section.



Itsukushima Shrine, Miyajima.

Practice Questions

Questions 37-39: Reconstructions – Share Capital.

Question 37

Chill Vibes has provided the following income statement and unclassified balance sheet.

Chill Vibes Income Statement For the year ended 30 June 2038		
Sales		700
Less sales returns		30
Less Cost of Sales		250
Gross Profit		420
Add Other Income		
Interest	40	
Discount received	30	
Gain on sale of property, plant and equipment	20	
Dividends	50	140
		560
Less Other Expenses		
Interest	30	
Advertising	9	
Other expenses	1	
Rent	60	
Doubtful debts	20	
Discount allowed	10	
Wages	20	
Depreciation of property, plant and equipment	40	190
Profit before Tax		370
Less Income tax expense		111
Profit after tax		259

Additional information:

- Proceeds from the sale of property, plant and equipment was \$50.
- Purchase returns for the year were \$10.
- Share issue costs during the period were \$1.

Chill Vibes Unclassified Balance Sheets As at 30 June 2038		
	30 June 2037	30 June 2038
Assets		
Cash at Bank	120	160
Accounts Receivable	40	50
Allowance for Doubtful Debts	(30)	(40)
Inventory	60	90
Prepaid rent	70	50
Accrued interest income	40	20
Investments (shares in companies)	150	150
Property, plant and Equipment	140	160
Less Accumulated Depreciation	(70)	(50)
Total Assets	520	590
Liabilities		
Accrued Wages	50	40
Income Tax Payable	10	20
Loan from Bank	0	60
Accounts Payable	20	30
Debentures	110	70
Total Liabilities	190	220
Equity		
Share Capital	150	160
General Reserve	110	90
Retained Earnings	70	120
Total Equity	330	370
Total Liabilities and Equity	520	590

Required Task:

a. Calculate the share capital proceeds for the year ended 30 June 2038.

Share Capital					
	Bank			Opening Share Capital	
	Closing Share Capital			Bank	

b. Describe the purpose of reconstructing the retained earnings account.

Question 38

Lo-Fi Hip Hop Radio Ltd has provided the following income statement and unclassified balance sheet.

Lo-Fi Hip Hop Radio Ltd Income Statement For the year ended 30 June 2043		
Sales		140
Less Cost of Sales		50
Gross Profit		90
Add Other Income		
Interest	5	
Discount received	4	
Dividends	7	16
		106
Less Other Expenses		
Interest	10	
Advertising	4	
Rent	15	
Wages	20	
Other expenses	20	
Depreciation of property, plant and equipment	7	76
Profit before Tax		30
Less Income tax expense		9
Profit after tax		21

Lo-Fi Hip Hop Radio Ltd Unclassified Balance Sheets As at 30 June 2043		
	30 June 2042	30 June 2043
Assets		
Cash at Bank	155	145
Accounts Receivable	40	50
Inventory	30	34
Prepaid advertising	5	6
Accrued interest income	12	8
Investments (shares in companies)	25	25
Property, plant and Equipment	80	90
Less Accumulated Depreciation	(60)	(35)
Total Assets	287	323
Liabilities		
Accrued Interest	8	4
Income Tax Payable	14	19
Accounts Payable	50	40
Debentures	40	35
Total Liabilities	112	98
Equity		
Share Capital	55	87
General Reserve	30	50
Retained Earnings	90	88
Total Equity	175	225
Total Liabilities and Equity	287	323

Additional information:

- Proceeds from the sale of property, plant and equipment was \$20.
- The loss on sale of property, plant and equipment was \$5 (within Other expenses).
- Share issue costs during the period were \$3 (not on income statement as it is a closed account).

Required Task:

a. Calculate the share capital proceeds for the year ended 30 June 2043.

Share Capital					

Question 39

Vogue Styles has provided the following income statement and unclassified balance sheet.

Vogue Styles Income Statement For the year ended 30 June 2038		
Sales		128
Less sales returns		16
Less Cost of Sales		61
Gross Profit		51
Add Other Income		
Interest	5	
Discount received	2	
Dividends	4	11
		62
Less Other Expenses		
Interest	1	
Insurance	3	
Rent	11	
Doubtful debts	4	
Selling and distribution expense	5	
Loss on sale of machinery	3	
Wages	4	
Depreciation of property, plant and equipment	12	43
Profit before Tax		19
Less Income tax expense		5.7
Profit after tax		13.3

Additional information:

- Proceeds from the machinery was \$15.
- Purchase returns for the year were \$6.
- Share issue costs were \$4.
- The loan from bank is due within 9 months.

Vogue Styles Unclassified Balance Sheets As at 30 June 2038		
	30 June 2038	30 June 2037
Assets		
Cash at Bank	144	148
Accounts Receivable	45	50
Allowance for Doubtful Debts	(6)	(5)
Inventory	28	25
Prepaid insurance	5	7
Accrued interest income	6	12
Investments	21	23
Machinery	70	60
Less Accumulated Depreciation	(29)	(40)
Total Assets	284	280
Liabilities		
Accrued selling and distribution expense	8	6
Income Tax Payable	5	3
Loan from Bank	3	0
Accounts Payable	55	60
Accrued wages	2	4
Debentures	18	26
Total Liabilities	91	99
Equity		
Share Capital	76	61
General Reserve	47	40
Retained Earnings	70	80
Total Equity	193	181
Total Liabilities and Equity	284	280

Required Task:

a. Calculate the share capital proceeds for the year ended 30 June 2038.

Share Capital					

Reconstructions – Prepaid Expense

If prepaid expenses are present on the balance sheet, the prepaid expense account must be reconstructed to find the cash paid for the expense. The cash paid for the expense appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

Example

Big Tings Ltd has provided the following income statement and unclassified balance sheet. Entries relevant to the reconstruction of the prepaid expense account have been highlighted.

Big Tings Ltd Income Statement For the year ended 30 June 2035		
Sales		80,000
Less sales returns		5,000
Less Cost of Sales		35,000
Gross Profit		40,000
Add Other Income		
Interest	1,000	
Discount received	2,500	
Gain on sale of property, plant and equipment	5,000	
Dividends	3,000	11,500
		51,500
Less Other Expenses		
Interest	1,800	
Advertising	1,000	
Rent	8,000	
Doubtful debts	2,500	
Discount allowed	1,000	
Wages	1,600	
Depreciation of property, plant and equipment	4,000	19,900
Profit before Tax		31,600
Less Income tax expense		9,480
Profit after tax		\$22,120

Additional information:

- Share issue costs were \$4,000.
- Proceeds from the sale of property, plant and equipment was \$12,000.

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Assets		
Cash at Bank	3,000	11,500
Accounts Receivable	3,000	4,000
Allowance for Doubtful Debts	(500)	(400)
Inventory	12,000	15,000
Prepaid rent	5,000	3,000
Accrued interest income	2,000	500
Investments (shares in companies)	20,000	20,000
Property, plant and equipment	50,000	70,000
Less Accumulated Depreciation	(8,000)	(10,000)
Total Assets	86,500	113,600
Liabilities		
Accrued Wages	1,000	1,500
Income Tax Payable	4,000	5,000
Accounts Payable	3,000	5,000
Loan from Bank	0	10,000
Debentures	7,500	4,700
Total Liabilities	15,500	26,200
Equity		
Share Capital	40,000	55,000
General Reserve	16,000	14,400
Retained Earnings	15,000	18,000
Total Liabilities and Equity	86,500	113,600

Required task:

Calculate the cash paid for rent for the year ended 30 June 2035.

Solution

Prepaid Rent		
	Opening Balance	5,000
	Bank	6,000
		11,000
	Rent (expense)	8,000
	Closing Balance	3,000
		11,000

Therefore, the cash paid for rent was \$6,000 for the year ended 30 June 2035.

Reconstruction of prepaid expense account purpose: The bank figure calculated when reconstructing the prepaid expense account is the cash paid for the expense. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

Practice Questions

Questions 40-42: Reconstructions – Prepaid Expense.

Question 40

Chill Vibes has provided the following income statement and unclassified balance sheet.

Chill Vibes Income Statement For the year ended 30 June 2038		
Sales		700
Less sales returns		30
Less Cost of Sales		250
Gross Profit		420
Add Other Income		
Interest	40	
Discount received	30	
Gain on sale of property, plant and equipment	20	
Dividends	50	140
		560
Less Other Expenses		
Interest	30	
Advertising	9	
Other expenses	1	
Rent	60	
Doubtful debts	20	
Discount allowed	10	
Wages	20	
Depreciation of property, plant and equipment	40	190
Profit before Tax		370
Less Income tax expense		111
Profit after tax		259

Chill Vibes Unclassified Balance Sheets As at 30 June 2038		
	30 June 2037	30 June 2038
Assets		
Cash at Bank	120	160
Accounts Receivable	40	50
Allowance for Doubtful Debts	(30)	(40)
Inventory	60	90
Prepaid rent	70	50
Accrued interest income	40	20
Investments (shares in companies)	150	150
Property, plant and Equipment	140	160
Less Accumulated Depreciation	(70)	(50)
Total Assets	520	590
Liabilities		
Accrued Wages	50	40
Income Tax Payable	10	20
Loan from Bank	0	60
Accounts Payable	20	30
Debentures	110	70
Total Liabilities	190	220
Equity		
Share Capital	150	160
General Reserve	110	90
Retained Earnings	70	120
Total Equity	330	370
Total Liabilities and Equity	520	590

Additional information:

- Proceeds from the sale of property, plant and equipment was \$50.
- Purchase returns for the year were \$10.
- Share issue costs during the period were \$1.

Required task:

a. Calculate the rent expense paid for the year ended 30 June 2038.

Prepaid Rent					
	Opening Balance			Rent (expense)	
	Bank			Closing Balance	

b. Describe the purpose of reconstructing the prepaid expense account.

Question 41

Lo-Fi Hip Hop Radio Ltd has provided the following income statement and unclassified balance sheet.

Lo-Fi Hip Hop Radio Ltd Income Statement For the year ended 30 June 2043		
Sales		140
Less Cost of Sales		50
Gross Profit		90
Add Other Income		
Interest	5	
Discount received	4	
Dividends	7	16
		106
Less Other Expenses		
Interest	10	
Advertising	4	
Rent	15	
Wages	20	
Other expenses	20	
Depreciation of property, plant and equipment	7	76
Profit before Tax		30
Less Income tax expense		9
Profit after tax		21

Lo-Fi Hip Hop Radio Ltd Unclassified Balance Sheets As at 30 June 2043		
	30 June 2042	30 June 2043
Assets		
Cash at Bank	155	145
Accounts Receivable	40	50
Inventory	30	34
Prepaid advertising	5	6
Accrued interest income	12	8
Investments (shares in companies)	25	25
Property, plant and Equipment	80	90
Less Accumulated Depreciation	(60)	(35)
Total Assets	287	323
Liabilities		
Accrued Interest	8	4
Income Tax Payable	14	19
Accounts Payable	50	40
Debentures	40	35
Total Liabilities	112	98
Equity		
Share Capital	55	87
General Reserve	30	50
Retained Earnings	90	88
Total Equity	175	225
Total Liabilities and Equity	287	323

Additional information:

- Proceeds from the sale of property, plant and equipment was \$20.
- The loss on sale of property, plant and equipment was \$5 (within Other expenses).
- Share issue costs during the period were \$3 (not on income statement as it is a closed account).

Required task:

a. Calculate the advertising expense paid for the year ended 30 June 2043.

Prepaid Advertising					

Question 42

Vogue Styles has provided the following income statement and unclassified balance sheet.

Vogue Styles Income Statement For the year ended 30 June 2038		
Sales		128
Less sales returns		16
Less Cost of Sales		61
Gross Profit		51
Add Other Income		
Interest	5	
Discount received	2	
Dividends	4	11
		62
Less Other Expenses		
Interest	1	
Insurance	3	
Rent	11	
Doubtful debts	4	
Selling and distribution expense	5	
Loss on sale of machinery	3	
Wages	4	
Depreciation of property, plant and equipment	12	43
Profit before Tax		19
Less Income tax expense		5.7
Profit after tax		13.3

Additional information:

- Proceeds from the machinery was \$15.
- Purchase returns for the year were \$6.
- Share issue costs were \$4.
- The loan from bank is due within 9 months.

Vogue Styles Unclassified Balance Sheets As at 30 June 2038		
	30 June 2038	30 June 2037
Assets		
Cash at Bank	144	148
Accounts Receivable	45	50
Allowance for Doubtful Debts	(6)	(5)
Inventory	28	25
Prepaid insurance	5	7
Accrued interest income	6	12
Investments	21	23
Machinery	70	60
Less Accumulated Depreciation	(29)	(40)
Total Assets	284	280
Liabilities		
Accrued selling and distribution expense	8	6
Income Tax Payable	5	3
Loan from Bank	3	0
Accounts Payable	55	60
Accrued wages	2	4
Debentures	18	26
Total Liabilities	91	99
Equity		
Share Capital	76	61
General Reserve	47	40
Retained Earnings	70	80
Total Equity	193	181
Total Liabilities and Equity	284	280

Required task:

a. Calculate the insurance expense paid for the year ended 30 June 2038.

Prepaid Insurance					

Reconstructions – Accrued Expense

If the balance sheet includes an accrued expense, this account must be reconstructed to find the expense paid. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

Example

Big Tings Ltd has provided the following income statement and unclassified balance sheet. Entries relevant to the reconstruction of the accrued expense account have been highlighted.

Big Tings Ltd Income Statement For the year ended 30 June 2035		
Sales		80,000
Less sales returns		5,000
Less Cost of Sales		35,000
Gross Profit		40,000
Add Other Income		
Interest	1,000	
Discount received	2,500	
Gain on sale of property, plant and equipment	5,000	
Dividends	3,000	11,500
		51,500
Less Other Expenses		
Interest	1,800	
Advertising	1,000	
Rent	8,000	
Doubtful debts	2,500	
Discount allowed	1,000	
Wages	1,600	
Depreciation of property, plant and equipment	4,000	19,900
Profit before Tax		31,600
Less Income tax expense		9,480
Profit after tax		\$22,120

Additional information:

- Share issue costs were \$4,000.
- Proceeds from the sale of property, plant and equipment was \$12,000.

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Assets		
Cash at Bank	3,000	11,500
Accounts Receivable	3,000	4,000
Allowance for Doubtful Debts	(500)	(400)
Inventory	12,000	15,000
Prepaid rent	5,000	3,000
Accrued interest income	2,000	500
Investments (shares in companies)	20,000	20,000
Property, plant and equipment	50,000	70,000
Less Accumulated Depreciation	(8,000)	(10,000)
Total Assets	86,500	113,600
Liabilities		
Accrued Wages	1,000	1,500
Income Tax Payable	4,000	5,000
Accounts Payable	3,000	5,000
Loan from Bank	0	10,000
Debentures	7,500	4,700
Total Liabilities	15,500	26,200
Equity		
Share Capital	40,000	55,000
General Reserve	16,000	14,400
Retained Earnings	15,000	18,000
Total Liabilities	71,000	87,400
Total Liabilities and Equity	86,500	113,600

Required task:

Calculate the wages paid for the year ended 30 June 2035.

Solution 1

Step 1 – Reconstruction of expense inside the Accrued expense account

Accrued Wages Expense					
	Bank	1,100		Opening Accrued Expense	1,000
	Closing Accrued Expense	1,500		Wages Expense	1,600
		2,600			2,600

Therefore, the wages expense paid was \$1,100 for the year ended 30 June 2035.

Reconstruction of accrued expense account purpose: The bank figure calculated when reconstructing the accrued expenses in the expense account is the expense paid. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

Solution 2

Step 1 – Reconstruction of the accrued expense account.

Accrued Wages					
	Bank	1,000		Opening Accrued Expense	1,000

Reconstruction of accrued expense account purpose: To find the accrued expense value. This is added to the expense account value to find the total expense paid. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

*Note: The bank figure in the accrued expense account reflects a **portion** of the expense paid. The entry on the credit side reflects the figure found in the balance sheet that opened the account.*

Step 2 – Reconstruction of the expense account.

Wages					
	Closing Accrued Expense	1,500		Wages Expense	1,600
	Bank	100			
		1,600			1,600

$$\begin{aligned}\text{Expense paid} &= \text{Expense} + \text{Accrued expense} \\ &= 1,000 + 100 \\ &= 1,100\end{aligned}$$

Therefore, the wages expense paid was \$1,100 for the year ended 30 June 2035.

Reconstruction of expense account purpose: The bank figures calculated in the accrued expense and expense account are added together to find the total expense paid. This appears in the SCF by being added to 'Payments to suppliers and employees' in the 'Cash flows from operating activities' section.

Practice Questions

Questions 43-45: Reconstructions – Accrued Expense.

Tip	<p>When to carry out the accrued expense reconstruction</p> <p>Assessment questions may try to distract you from knowing when to perform the accrued expense account reconstruction by using less common accrued accounts. Apart from commonly seen accrued expense accounts, look out for 'accrued selling and distribution expense' and 'accrued interest expense'. The hint is that if you see the word 'accrued' in front of a liability in the balance sheet, perform the accrued expense reconstruction.</p>
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Question 43

Chill Vibes has provided the following income statement and unclassified balance sheet.

Chill Vibes Income Statement For the year ended 30 June 2038		
Sales		700
Less sales returns		30
Less Cost of Sales		250
Gross Profit		420
Add Other Income		
Interest	40	
Discount received	30	
Gain on sale of property, plant and equipment	20	
Dividends	50	140
		560
Less Other Expenses		
Interest	30	
Advertising	9	
Other expenses	1	
Rent	60	
Doubtful debts	20	
Discount allowed	10	
Wages	20	
Depreciation of property, plant and equipment	40	190
Profit before Tax		370
Less Income tax expense		111
Profit after tax		259

Chill Vibes Unclassified Balance Sheets As at 30 June 2038		
	30 June 2037	30 June 2038
Assets		
Cash at Bank	120	160
Accounts Receivable	40	50
Allowance for Doubtful Debts	(30)	(40)
Inventory	60	90
Prepaid rent	70	50
Accrued interest income	40	20
Investments (shares in companies)	150	150
Property, plant and Equipment	140	160
Less Accumulated Depreciation	(70)	(50)
Total Assets	520	590
Liabilities		
Accrued Wages	50	40
Income Tax Payable	10	20
Loan from Bank	0	60
Accounts Payable	20	30
Debentures	110	70
Total Liabilities	190	220
Equity		
Share Capital	150	160
General Reserve	110	90
Retained Earnings	70	120
Total Equity	330	370
Total Liabilities and Equity	520	590

Additional information:

- Proceeds from the sale of property, plant and equipment was \$50.
- Purchase returns for the year were \$10.
- Share issue costs during the period were \$1.

Required task:

a. Calculate the wages expense paid for the year ended 30 June 2038.

Accrued Wages Expense				
	Bank			Opening Accrued Expense
	Closing Accrued Expense			Wages Expense

b. Describe the purpose of reconstructing the accrued expense account.

Question 44

Lo-Fi Hip Hop Radio Ltd has provided the following income statement and unclassified balance sheet.

Lo-Fi Hip Hop Radio Ltd Income Statement For the year ended 30 June 2043		
Sales		140
Less Cost of Sales		50
Gross Profit		90
Add Other Income		
Interest	5	
Discount received	4	
Dividends	7	16
		106
Less Other Expenses		
Interest	10	
Advertising	4	
Rent	15	
Wages	20	
Other expenses	20	
Depreciation of property, plant and equipment	7	76
Profit before Tax		30
Less Income tax expense		9
Profit after tax		21

Lo-Fi Hip Hop Radio Ltd Unclassified Balance Sheets As at 30 June 2043		
	30 June 2042	30 June 2043
Assets		
Cash at Bank	155	145
Accounts Receivable	40	50
Inventory	30	34
Prepaid advertising	5	6
Accrued interest income	12	8
Investments (shares in companies)	25	25
Property, plant and Equipment	80	90
Less Accumulated Depreciation	(60)	(35)
Total Assets	287	323
Liabilities		
Accrued Interest	8	4
Income Tax Payable	14	19
Accounts Payable	50	40
Debentures	40	35
Total Liabilities	112	98
Equity		
Share Capital	55	87
General Reserve	30	50
Retained Earnings	90	88
Total Equity	175	225
Total Liabilities and Equity	287	323

Additional information:

- Proceeds from the sale of property, plant and equipment was \$20.
- The loss on sale of property, plant and equipment was \$5 (within Other expenses).
- Share issue costs during the period were \$3 (not on income statement as it is a closed account).

Required task:

a. Calculate the interest expense paid for the year ended 30 June 2043.

Accrued Interest expense					

Question 45

Vogue Styles has provided the following income statement and unclassified balance sheet.

Vogue Styles Income Statement For the year ended 30 June 2038		
Sales		128
Less sales returns		16
Less Cost of Sales		61
Gross Profit		51
Add Other Income		
Interest	5	
Discount received	2	
Dividends	4	11
		62
Less Other Expenses		
Interest	1	
Insurance	3	
Rent	11	
Doubtful debts	4	
Selling and distribution expense	5	
Loss on sale of machinery	3	
Wages	4	
Depreciation of property, plant and equipment	12	43
Profit before Tax		19
Less Income tax expense		5.7
Profit after tax		13.3

Additional information:

- Proceeds from the machinery was \$15.
- Purchase returns for the year were \$6.
- Share issue costs were \$4.
- The loan from bank is due within 9 months.

Vogue Styles Unclassified Balance Sheets As at 30 June 2038		
	30 June 2038	30 June 2037
Assets		
Cash at Bank	144	148
Accounts Receivable	45	50
Allowance for Doubtful Debts	(6)	(5)
Inventory	28	25
Prepaid insurance	5	7
Accrued interest income	6	12
Investments	21	23
Machinery	70	60
Less Accumulated Depreciation	(29)	(40)
Total Assets	284	280
Liabilities		
Accrued selling and distribution expense	8	6
Income Tax Payable	5	3
Loan from Bank	3	0
Accounts Payable	55	60
Accrued wages	2	4
Debentures	18	26
Total Liabilities	91	99
Equity		
Share Capital	76	61
General Reserve	47	40
Retained Earnings	70	80
Total Equity	193	181
Total Liabilities and Equity	284	280

Required task:

a. Calculate the wages expense paid for the year ended 30 June 2038.

Accrued Wages Expense					

b. Calculate the selling and distribution expense paid for the year ended 30 June 2038.

Accrued Selling and Distribution Expense					

Reconstructions – Accrued Income

When the balance sheet includes accrued income, such as accrued interest income accounts must be reconstructed to find the interest income received. This appears in the SCF as interest received in the “Cash flows from Investing Activities”.

Example

Big Tings Ltd has provided the following income statement and unclassified balance sheet. Entries relevant to the reconstruction of the accrued income account have been highlighted.

Big Tings Ltd Income Statement For the year ended 30 June 2035		
Sales		80,000
Less sales returns		5,000
Less Cost of Sales		35,000
Gross Profit		40,000
Add Other Income		
Interest	1,000	
Discount received	2,500	
Gain on sale of property, plant and equipment	5,000	
Dividends	3,000	11,500
		51,500
Less Other Expenses		
Interest	1,800	
Advertising	1,000	
Rent	8,000	
Doubtful debts	2,500	
Discount allowed	1,000	
Wages	1,600	
Depreciation of property, plant and equipment	4,000	19,900
Profit before Tax		31,600
Less Income tax expense		9,480
Profit after tax		\$22,120

Additional information:

- Share issue costs were \$4,000.
- Proceeds from the sale of property, plant and equipment was \$12,000.

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Assets		
Cash at Bank	3,000	11,500
Accounts Receivable	3,000	4,000
Allowance for Doubtful Debts	(500)	(400)
Inventory	12,000	15,000
Prepaid rent	5,000	3,000
Accrued interest income	2,000	500
Investments (shares in companies)	20,000	20,000
Property, plant and equipment	50,000	70,000
Less Accumulated Depreciation	(8,000)	(10,000)
Total Assets	86,500	113,600
Liabilities		
Accrued Wages	1,000	1,500
Income Tax Payable	4,000	5,000
Accounts Payable	3,000	5,000
Loan from Bank	0	10,000
Debentures	7,500	4,700
Total Liabilities	15,500	26,200
Equity		
Share Capital	40,000	55,000
General Reserve	16,000	14,400
Retained Earnings	15,000	18,000
Total Liabilities	71,000	87,400
Total Liabilities and Equity	86,500	113,600

Required task:

Calculate the interest income received for the year ended 30 June 2035.

Solution 1

Accrued Interest Income					
	Opening Accrued Interest Income	2,000		Bank	2,500
	Interest income	1,000		Closing Accrued Interest Income	500
		3,000			3,000

Therefore, the interest income received was \$2,500 for the year ended 30 June 2035.

Reconstruction of accrued income purpose: The bank figure calculated when reconstructing the accrued income account is the interest income received. This appears in the SCF as interest received in the "Cash flows from Investing Activities".

Solution 2

Step 1 – Reconstruction of the Accrued Interest Income Account.

Accrued Interest Income					
	Opening Accrued Interest Income	2,000		Bank	2,000

Reconstruction of accrued interest income account purpose: To find the accrued income value. This is added to the interest income account value to find the interest income received.

*Note: The bank figure in the accrued interest income account reflects a **portion** of the interest received. The entry on the credit side reflects the figure found in the balance sheet that closed the account.*

Step 2 – Reconstruction of the Interest Income Account.

Interest Income					
	Profit and Loss	1,000		Closing Accrued Interest Income	500
				Bank	500
		1,000			1,000

$$\begin{aligned}\text{Income received} &= \text{Interest Income} + \text{Accrued Interest Income} \\ &= 500 + 2,000 \\ &= 2,500\end{aligned}$$

Therefore, the interest income received was \$2,500 for the year ended 30 June 2035.

Reconstruction of Expense account purpose: The bank figures calculated in the accrued interest income and interest income account are added together to find the total interest income received. This appears in the SCF as interest received in the "Cash flows from Investing Activities".

Practice Questions

Questions 46-48: Reconstructions – Accrued Income.

Question 46

Chill Vibes has provided the following income statement and unclassified balance sheet.

Chill Vibes Income Statement For the year ended 30 June 2038		
Sales		700
Less sales returns		30
Less Cost of Sales		250
Gross Profit		420
Add Other Income		
Interest	40	
Discount received	30	
Gain on sale of property, plant and equipment	20	
Dividends	50	140
		560
Less Other Expenses		
Interest	30	
Advertising	9	
Other expenses	1	
Rent	60	
Doubtful debts	20	
Discount allowed	10	
Wages	20	
Depreciation of property, plant and equipment	40	190
Profit before Tax		370
Less Income tax expense		111
Profit after tax		259

Additional information:

- Proceeds from the sale of property, plant and equipment was \$50.
- Purchase returns for the year were \$10.
- Share issue costs during the period were \$1.

Chill Vibes Unclassified Balance Sheets As at 30 June 2038		
	30 June 2037	30 June 2038
Assets		
Cash at Bank	120	160
Accounts Receivable	40	50
Allowance for Doubtful Debts	(30)	(40)
Inventory	60	90
Prepaid rent	70	50
Accrued interest income	40	20
Investments (shares in companies)	150	150
Property, plant and Equipment	140	160
Less Accumulated Depreciation	(70)	(50)
Total Assets	520	590
Liabilities		
Accrued Wages	50	40
Income Tax Payable	10	20
Loan from Bank	0	60
Accounts Payable	20	30
Debentures	110	70
Total Liabilities	190	220
Equity		
Share Capital	150	160
General Reserve	110	90
Retained Earnings	70	120
Total Equity	330	370
Total Liabilities and Equity	520	590

Required task:

a. Calculate the interest income received for the year ended 30 June 2038.

Accrued Interest Income					
	Opening Accrued Interest Income			Bank	
	Profit and Loss			Closing Accrued Interest Income	

b. Describe the purpose of reconstructing accrued income.

Question 47

Lo-Fi Hip Hop Radio Ltd has provided the following income statement and unclassified balance sheet.

Lo-Fi Hip Hop Radio Ltd Income Statement For the year ended 30 June 2043		
Sales		140
Less Cost of Sales		50
Gross Profit		90
Add Other Income		
Interest	5	
Discount received	4	
Dividends	7	16
		106
Less Other Expenses		
Interest	10	
Advertising	4	
Rent	15	
Wages	20	
Other expenses	20	
Depreciation of property, plant and equipment	7	76
Profit before Tax		30
Less Income tax expense		9
Profit after tax		21

Lo-Fi Hip Hop Radio Ltd Unclassified Balance Sheets As at 30 June 2043		
	30 June 2042	30 June 2043
Assets		
Cash at Bank	155	145
Accounts Receivable	40	50
Inventory	30	34
Prepaid advertising	5	6
Accrued interest income	12	8
Investments (shares in companies)	25	25
Property, plant and Equipment	80	90
Less Accumulated Depreciation	(60)	(35)
Total Assets	287	323
Liabilities		
Accrued Interest	8	4
Income Tax Payable	14	19
Accounts Payable	50	40
Debentures	40	35
Total Liabilities	112	98
Equity		
Share Capital	55	87
General Reserve	30	50
Retained Earnings	90	88
Total Equity	175	225
Total Liabilities and Equity	287	323

Additional information:

- Proceeds from the sale of property, plant and equipment was \$20.
- The loss on sale of property, plant and equipment was \$5 (within Other expenses).
- Share issue costs during the period were \$3 (not on income statement as it is a closed account).

Required task:

a. Calculate the interest income received for the year ended 30 June 2043.

Accrued Interest Income					

Question 48

Vogue Styles has provided the following income statement and unclassified balance sheet.

Vogue Styles Income Statement For the year ended 30 June 2038		
Sales		128
Less sales returns		16
Less Cost of Sales		61
Gross Profit		51
Add Other Income		
Interest	5	
Discount received	2	
Dividends	4	11
		62
Less Other Expenses		
Interest	1	
Insurance	3	
Rent	11	
Doubtful debts	4	
Selling and distribution expense	5	
Loss on sale of machinery	3	
Wages	4	
Depreciation of property, plant and equipment	12	43
Profit before Tax		19
Less Income tax expense		5.7
Profit after tax		13.3

Additional information:

- Proceeds from the machinery was \$15.
- Purchase returns for the year were \$6.
- Share issue costs were \$4.
- The loan from bank is due within 9 months.

Vogue Styles Unclassified Balance Sheets As at 30 June 2038		
	30 June 2038	30 June 2037
Assets		
Cash at Bank	144	148
Accounts Receivable	45	50
Allowance for Doubtful Debts	(6)	(5)
Inventory	28	25
Prepaid insurance	5	7
Accrued interest income	6	12
Investments	21	23
Machinery	70	60
Less Accumulated Depreciation	(29)	(40)
Total Assets	284	280
Liabilities		
Accrued selling and distribution expense	8	6
Income Tax Payable	5	3
Loan from Bank	3	0
Accounts Payable	55	60
Accrued wages	2	4
Debentures	18	26
Total Liabilities	91	99
Equity		
Share Capital	76	61
General Reserve	47	40
Retained Earnings	70	80
Total Equity	193	181
Total Liabilities and Equity	284	280

Required task:

a. Calculate the interest income received for the year ended 30 June 2038.

Accrued Interest Income					

Reconstructions – Sale and Purchase of Non-Current Assets

When a non-current asset is sold or purchased, three account reconstructions are required to find the cash received for the NCA sold and the cash paid for the new NCA. This appears in the SCF as “Proceeds of sale of plant and equipment” and “Payment for NCA” in the “Cash flows from investing activities” section.

Example

Big Tings Ltd has provided the following income statement and unclassified balance sheet. Entries relevant to reconstruction of the accumulated depreciation of NCA, sale of asset and non-current asset accounts have been highlighted.

Big Tings Ltd Income Statement For the year ended 30 June 2035		
Sales		80,000
Less sales returns		5,000
Less Cost of Sales		35,000
Gross Profit		40,000
Add Other Income		
Interest	1,000	
Discount received	2,500	
Gain on sale of property, plant and equipment	5,000	
Dividends	3,000	11,500
		51,500
Less Other Expenses		
Interest	1,800	
Advertising	1,000	
Rent	8,000	
Doubtful debts	2,500	
Discount allowed	1,000	
Wages	1,600	
Depreciation of property, plant and equipment	4,000	19,900
Profit before Tax		31,600
Less Income tax expense		9,480
Profit after tax		\$22,120

Additional information:

- Share issue costs were \$4,000.
- Proceeds from the sale of property, plant and equipment was \$12,000.

Big Tings Ltd Unclassified Balance Sheets As at 30 June 2035		
	30 June 2034	30 June 2035
Assets		
Cash at Bank	3,000	11,500
Accounts Receivable	3,000	4,000
Allowance for Doubtful Debts	(500)	(400)
Inventory	12,000	15,000
Prepaid rent	5,000	3,000
Accrued interest income	2,000	500
Investments (shares in companies)	20,000	20,000
Property, plant and equipment	50,000	70,000
Less Accumulated Depreciation	(8,000)	(10,000)
Total Assets	\$86,500	\$113,600
Liabilities		
Accrued Wages	1,000	1,500
Income Tax Payable	4,000	5,000
Accounts Payable	3,000	5,000
Loan from Bank	0	10,000
Debentures	7,500	4,700
Total Liabilities	15,500	26,200
Equity		
Share Capital	40,000	55,000
General Reserve	16,000	14,400
Retained Earnings	15,000	18,000
Total Liabilities	71,000	87,400
Total Liabilities and Equity	86,500	113,600

Required task:

Calculate the cash received for sale of non-current assets and cash paid for non-current assets for the year ended 30 June 2035.

Solution**Step 1 – Reconstruction of the Accumulated Depreciation of NCA Account.**

Accumulated Depreciation of NCA					
	Sale of Asset	2,000		Opening Balance	8,000
	Closing Balance	10,000		Depreciation	4,000
		12,000			12,000

Reconstruction of Accumulated Depreciation of NCA account purpose: The sale of asset figure calculated when reconstructing the accumulated depreciation account is transferred to the sale of asset account.

Step 2 – Reconstruction of the Sale of Asset Account.

Sale of Asset					
	Property, plant and equipment	9,000		Accumulated Depreciation	2,000
	Gain on sale	5,000		Bank	12,000
		14,000			14,000

The bank figure comes from the additional information. This is the proceeds from the sale of property, plant and equipment.

Gain or loss on sale:

- Gain on sale = Debit side.
- Loss on Sale = Credit side.

Therefore, the proceeds of the sale of the non-current asset was \$12,000 for the year ended 30 June 2035.

Reconstruction of Sale of Asset account purpose:

- The bank figure calculated when reconstructing the sale of asset account is cash received from the sale of the NCA. This appears in the SCF as "Proceeds of sale of plant and equipment" in the "Cash flows from investing activities" section.
- The Property, Plant and Equipment figure calculated when reconstructing the sale of asset account is the purchase price of the NCA that was sold. This is transferred to the Sale of Asset Account.

Step 3 – Reconstruction of the Non-Current Asset Account.

Property, plant and equipment					
	Opening balance	50,000		Sale of Asset	9,000
	Bank	29,000		Closing balance	70,000
		79,000			79,000

Therefore, the cash paid for the non-current asset was \$29,000 for the year ended 30 June 2035.

Reconstruction of Property, plant and equipment account purpose: The bank figure calculated when reconstructing the non-current asset account is the cash paid for the NCA. This appears in the SCF as "Payment for NCA" in the "Cash flows from investing activities" section.

Practice Questions

Questions 49-51: Sale and Purchase of Non-Current Assets.

Question 49

Chill Vibes has provided the following income statement and unclassified balance sheet.

Chill Vibes Income Statement For the year ended 30 June 2038		
Sales		700
Less sales returns		30
Less Cost of Sales		250
Gross Profit		420
Add Other Income		
Interest	40	
Discount received	30	
Gain on sale of property, plant and equipment	20	
Dividends	50	140
		560
Less Other Expenses		
Interest	30	
Advertising	9	
Other expenses	1	
Rent	60	
Doubtful debts	20	
Discount allowed	10	
Wages	20	
Depreciation of property, plant and equipment	40	190
Profit before Tax		370
Less Income tax expense		111
Profit after tax		259

Chill Vibes Unclassified Balance Sheets As at 30 June 2038		
	30 June 2037	30 June 2038
Assets		
Cash at Bank	120	160
Accounts Receivable	40	50
Allowance for Doubtful Debts	(30)	(40)
Inventory	60	90
Prepaid rent	70	50
Accrued interest income	40	20
Investments (shares in companies)	150	150
Property, plant and Equipment	140	160
Less Accumulated Depreciation	(70)	(50)
Total Assets	520	590
Liabilities		
Accrued Wages	50	40
Income Tax Payable	10	20
Loan from Bank	0	60
Accounts Payable	20	30
Debentures	110	70
Total Liabilities	190	220
Equity		
Share Capital	150	160
General Reserve	110	90
Retained Earnings	70	120
Total Equity	330	370
Total Liabilities and Equity	520	590

Additional information:

- Proceeds from the sale of property, plant and equipment was \$50.
- Purchase returns for the year were \$10.
- Share issue costs during the period were \$1.

Required tasks:

a. Calculate the cash paid for new property, plant and equipment and the cash received from the sale of property, plant and equipment for the year ended 30 June 2038.

Accumulated Depreciation of Property, plant and equipment				
	Sale of Asset			Opening Balance
	Closing Balance			Depreciation

Sale of Asset				
	Property, plant and equipment			Accumulated Depreciation
	Gain on sale			Bank

Property, plant and equipment					
	Opening balance			Sale of Asset	
	Bank			Closing balance	

b. Describe the purpose of reconstructing the accumulated depreciation of non-current asset account.

c. Describe the purpose of reconstructing the sale of asset account.

d. Describe the purpose of reconstructing the non-current asset account.

Question 50

Lo-Fi Hip Hop Radio Ltd has provided the following income statement and unclassified balance sheet.

Lo-Fi Hip Hop Radio Ltd Income Statement For the year ended 30 June 2043		
Sales		140
Less Cost of Sales		50
Gross Profit		90
Add Other Income		
Interest	5	
Discount received	4	
Dividends	7	16
		106
Less Other Expenses		
Interest	10	
Advertising	4	
Rent	15	
Wages	20	
Other expenses	20	
Depreciation of property, plant and equipment	7	76
Profit before Tax		30
Less Income tax expense		9
Profit after tax		21

Additional information:

- Proceeds from the sale of property, plant and equipment was \$20.
- The loss on sale of property, plant and equipment was \$5 (within Other expenses).
- Share issue costs during the period were \$3 (not on income statement as it is a closed account).

Lo-Fi Hip Hop Radio Ltd Unclassified Balance Sheets As at 30 June 2043		
	30 June 2042	30 June 2043
Assets		
Cash at Bank	155	145
Accounts Receivable	40	50
Inventory	30	34
Prepaid advertising	5	6
Accrued interest income	12	8
Investments (shares in companies)	25	25
Property, plant and Equipment	80	90
Less Accumulated Depreciation	(60)	(35)
Total Assets	287	323
Liabilities		
Accrued Interest	8	4
Income Tax Payable	14	19
Accounts Payable	50	40
Debentures	40	35
Total Liabilities	112	98
Equity		
Share Capital	55	87
General Reserve	30	50
Retained Earnings	90	88
Total Equity	175	225
Total Liabilities and Equity	287	323

Required tasks:

a. Calculate the cash paid for new property, plant and equipment and the cash received from the sale of property, plant and equipment for the year ended 30 June 2043.

Note: The loss on sale of equipment value appears on the income statement within the other expenses value. It is also given in the additional information.

Accumulated Depreciation of Property, plant and equipment					

Sale of Asset					

Property, plant and equipment					

Question 51

Vogue Styles has provided the following income statement and unclassified balance sheet.

Vogue Styles Income Statement For the year ended 30 June 2038		
Sales		128
Less sales returns		16
Less Cost of Sales		61
Gross Profit		51
Add Other Income		
Interest	5	
Discount received	2	
Dividends	4	11
		62
Less Other Expenses		
Interest	1	
Insurance	3	
Rent	11	
Doubtful debts	4	
Selling and distribution expense	5	
Loss on sale of machinery	3	
Wages	4	
Depreciation of property, plant and equipment	12	43
Profit before Tax		19
Less Income tax expense		5.7
Profit after tax		13.3

Additional information:

- Proceeds from the machinery was \$15.
- Purchase returns for the year were \$6.
- Share issue costs were \$4.
- The loan from bank is due within 9 months.

Vogue Styles Unclassified Balance Sheets As at 30 June 2038		
	30 June 2038	30 June 2037
Assets		
Cash at Bank	144	148
Accounts Receivable	45	50
Allowance for Doubtful Debts	(6)	(5)
Inventory	28	25
Prepaid insurance	5	7
Accrued interest income	6	12
Investments	21	23
Machinery	70	60
Less Accumulated Depreciation	(29)	(40)
Total Assets	284	280
Liabilities		
Accrued selling and distribution expense	8	6
Income Tax Payable	5	3
Loan from Bank	3	0
Accounts Payable	55	60
Accrued wages	2	4
Debentures	18	26
Total Liabilities	91	99
Equity		
Share Capital	76	61
General Reserve	47	40
Retained Earnings	70	80
Total Equity	193	181
Total Liabilities and Equity	284	280

Required tasks:

a. Calculate the cash paid for new property, plant and equipment and the cash received from the sale of property, plant and equipment for the year ended 30 June 2038.

Accumulated Depreciation of Machinery					

Sale of Asset					

Machinery					

Reconstructions – Hidden cash expenses relating to Sale and Purchase of Non-Current Assets

In some questions the accumulated depreciation, gain or loss on sale may not be explicitly stated as a separate balance sheet item, income statement item or in the additional information.

- Example 1: The loss on sale and depreciation of a NCA sold may be hidden in other expenses. The loss on sale and depreciation are possible to be calculated.
- Example 2: A question may not provide the proceeds of sale of asset but provide the gain or loss on sale, carrying value of NCA sold. It is possible to calculate the proceeds of sale of the asset.

Example 1

The following information has been provided by a business for the year ended 30 June 2042.

Circ So Plei Ltd		
Income Statement (extract)		
For the year ended 30 June 2042		
Sales		80,000
Less Cost of Sales		35,000
Gross Profit		55,000
Less Other Expenses		
Rent	5,000	
Wages	15,000	
Other expenses	20,000	40,000
Profit before Tax		15,000

Circ So Plei Ltd		
Unclassified Balance Sheet (extract)		
As at 30 June 2042		
	30 June 2041	30 June 2042
Assets		
Motor Vehicles	35,000	48,000
Accumulated Depreciation of Motor Vehicles	(18,000)	(13,000)

Additional information

- A motor vehicle was sold during the year ended 30 June 2042.
- Proceeds of the sale of the motor vehicle was \$6,000.
- The cost price of the motor vehicle sold was \$18,000.
- The carrying value of the motor vehicle sold was \$8,000.

Required

Calculate the cash paid for the new motor vehicle and the cash received from the sale of the motor vehicle during the year ended 30 June 2042.

Solution

Step 1 – Reconstruction of the Accumulated Depreciation of NCA Account.

The missing value of the accumulated depreciation of the motor vehicle sold can be found using the following formula.

$$\begin{aligned}\text{Accumulated depreciation of NCA Sold} &= \text{Cost of NCA Sold} - \text{Carrying Amount of NCA} \\ &= 18,000 - 8,000 \\ &= 10,000\end{aligned}$$

This \$10,000 is the Sale of Asset figure debited in the Accumulated depreciation account below.

Once this accumulated depreciation of the asset that has been sold has been calculated, the Depreciation figure can then be calculated using the difference between Sale of Asset plus Closing balance and the Opening Balance.

Accumulated Depreciation of Motor Vehicles					
	Sale of Asset	10,000		Opening Balance	18,000
	Closing Balance	13,000		Depreciation	5,000
		23,000			23,000

Reconstruction of Accumulated Depreciation of NCA account purpose: The sale of asset figure calculated when reconstructing the accumulated depreciation account is transferred to the sale of asset account.

Step 2 – Reconstruction of the Sale of Asset Account

- The motor vehicles debit figure of \$18,000 is the cost price of the motor vehicle sold.
- The accumulated depreciation credit figure of \$10,000 was calculated in Step 1.
- The bank credit figure of \$6,000 is the proceeds of the sale of the motor vehicle.
- The loss on sale is calculated as the difference between the debit and credit sides.

Sale of Asset					
	Motor Vehicles	18,000		Accumulated Depreciation of Motor Vehicles	10,000
				Bank	6,000
				Loss on Sale	2,000
		18,000			18,000

Therefore, the cash received from the sale of motor vehicle was \$6,000 for the year ended 30 June 2042.

Gain or loss on sale:

- Gain on sale = Debit side.
- Loss on Sale = Credit side.

Reconstruction of Sale of Asset account purpose:

- The bank figure calculated when reconstructing the sale of asset account is cash received from the sale of the NCA. This appears in the SCF as "Proceeds of sale of plant and equipment" in the "Cash flows from investing activities" section.
- The Motor Vehicle figure calculated when reconstructing the sale of asset account is the purchase price of the NCA that was sold. This is transferred to the non-current asset account.

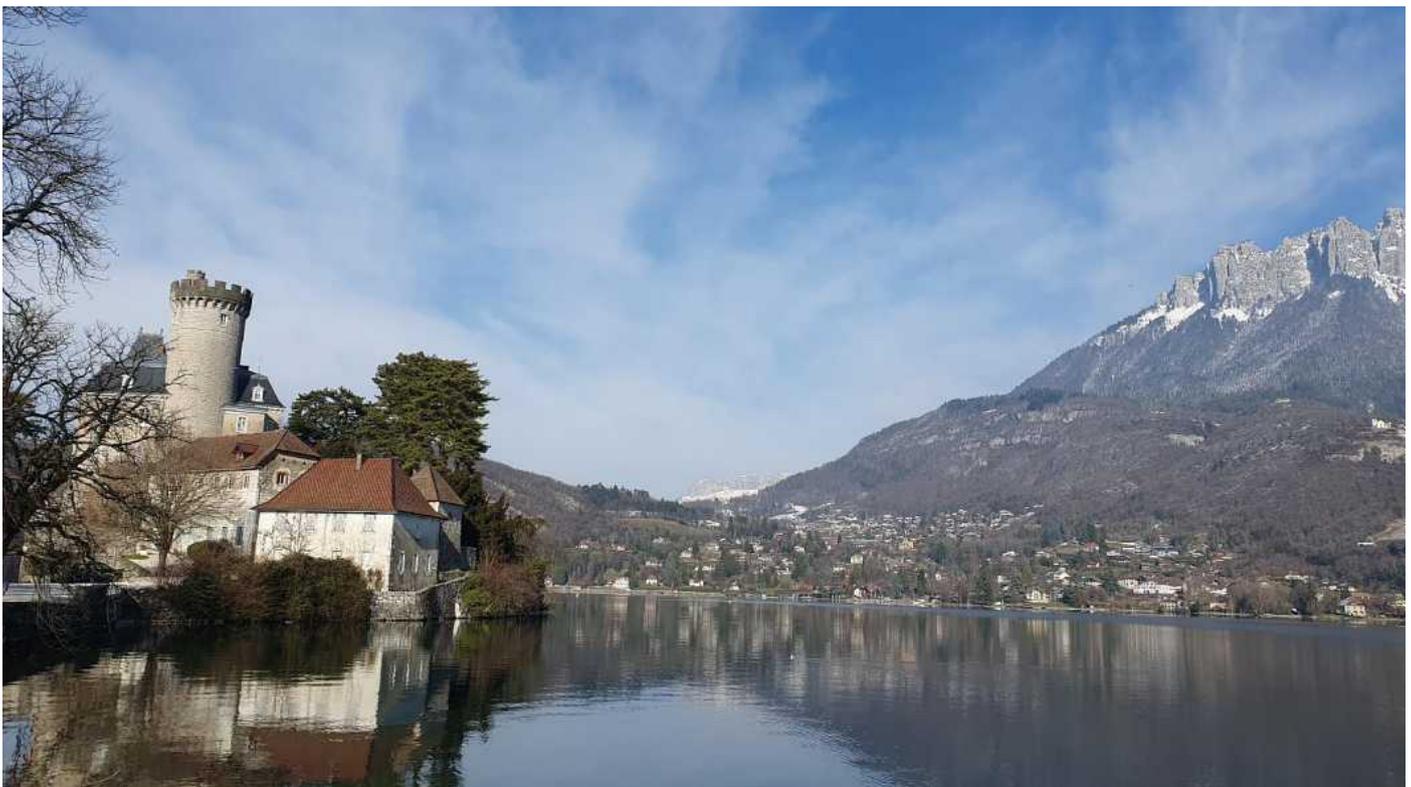
Step 3 – Reconstruction of the Non-Current Asset Account

- The opening and closing balance are provided in the question.
- The sale of asset credit figure of \$18,000 was provided in additional information as cost price of the motor vehicle.
- The bank figure of \$31,000 is the cash paid for the motor vehicle and is calculated as the difference between the debit and credit side.

Motor Vehicles					
	Opening balance	35,000		Sale of Asset	18,000
	Bank	31,000		Closing balance	48,000
		66,000			66,000

Therefore, the cash paid for the motor vehicle was \$31,000 for the year ended 30 June 2042.

Reconstruction of Sale of Asset account purpose: The bank figure calculated when reconstructing the non-current asset account is the cash paid for the motor vehicle. This appears in the SCF as “Payment for NCA” in the “Cash flows from investing activities” section.



Annecy, France.

Example 2

The following financial information for a business has been located across the business's income statement, balance sheet and additional information provided.

- Gain on sale of machinery was \$1,500.
- Accumulated depreciation of machinery sold was 10,000.
- Carrying amount of machinery sold was \$12,000.
- Machinery account opening balance was 30,000.
- Machinery account closing balance was 50,000.

Required task:

Calculate the

- Proceeds of sale of the machinery.
- Original cost of the machinery sold.
- The amount paid for the new machinery.

Solution

Step 1 – Reconstruction of Sale of Asset Account.

The proceeds of sale of the machinery can be found using the following formula.

Proceeds of sale of NCA = Carrying amount of NCA sold + Gain on Sale of Asset (or less Loss on Sale of Asset)

$$= 12,000 + 1,500$$

$$= 13,500$$

This becomes the credit figure of 'Bank \$13,500' in the Sale of Asset account.

The accumulated depreciation and gain on sale of asset was provided in the question.

The debit machinery entry is the purchase price of the machinery. This is found as the difference between the debit and credit sides.

Sale of Asset					
	Machinery	22,000		Accumulated Depreciation of Machinery	10,000
	Gain on Sale	1,500		Bank	13,500
		23,500			23,500

Therefore, the proceeds of sale of the machinery were \$13,500 and the original cost of the machinery was \$22,000.

Step 2 – Reconstruction of NCA Account.

The opening and closing balance of machinery was provided in the question. The Sale of Asset entry in the Machinery account was calculated in the previous step. The cash paid for the new machinery can now be found by reconstruction the machinery account.

Machinery					
	Opening balance	30,000		Sale of Asset	22,000
	Bank	42,000		Closing balance	50,000
		72,000			72,000

Therefore, the cash paid for the new machinery was \$42,000.

Practice Questions

Questions 52-55: Reconstructions – Hidden cash expenses relating to Sale and Purchase of NCAs.

- Questions 52-53: Method demonstrated in example 1.
- Questions 54-55: Method demonstrated in example 2.

Question 52

The following financial information has been provided by Pingoo's Igloos Ltd.

Pingoo's Igloos Ltd Income Statement (extract) For the year ended 30 June 2039		
Sales		136,000
Less Cost of Sales		54,000
Gross Profit		82,000
Less Other Expenses		
Rent	12,000	
Wages	16,000	
Other expenses	21,000	49,000
Profit before Tax		33,000

Pingoo's Igloos Ltd Unclassified Balance Sheet (extract) For the year ended 30 June 2039		
	30 June 2038	30 June 2039
Assets		
Motor Vehicles	53,000	61,000
Accumulated Depreciation of Motor Vehicles	26,000	15,000

Additional information

- A motor vehicle was sold during the year ended 30 June 2039.
- Proceeds of the sale of the motor vehicle was \$12,500.
- The cost price of the motor vehicle sold was \$28,000.
- The carrying value of the motor vehicle sold was \$13,000.

Required

Calculate the cash paid for new motor vehicle and the cash received from the sale of the motor vehicle during the year ended 30 June 2039.

Workings

Accumulated Depreciation of Motor Vehicles					

Sale of Asset					

Motor Vehicles					

Question 53

The following financial information has been provided by Big Bling Swag.

Big Bling Swag Income Statement (extract) For the year ended 30 June 2031		
Sales		45,000
Less Cost of Sales		35,000
Gross Profit		20,000
Less Other Expenses		
Rent	2,000	
Wages	4,000	
Other expenses	5,000	11,000
Profit before Tax		9,000

Big Bling Swag Unclassified Balance Sheet (extract) For the year ended 30 June 2031		
	30 June 2031	30 June 2030
Assets		
Office Equipment	14,000	11,000
Accumulated Depreciation of Office Equipment	6,000	8,000

Additional information

- Office equipment was sold during the year ended 30 June 2031.
- Proceeds of the sale of the office equipment was \$2,800.
- The cost price of the office equipment sold was \$10,000.
- The carrying value of the office equipment sold was \$4,000.

Required

Calculate the cash paid for new office equipment and the cash received from the sale of the office equipment during the year ended 30 June 2031.

Workings

Accumulated Depreciation of Office Equipment					

Sale of Asset					

Office Equipment					

Question 54

The following financial information has been located across an income statement, balance sheet and additional information.

- Gain on sale of machinery was \$750.
- Accumulated depreciation of machinery sold was \$6,000.
- Carrying amount of machinery sold was \$8,000.
- Machinery account opening balance was \$25,000.
- Machinery account closing balance was \$31,000.

Required tasks:

a. Calculate the proceeds of sale of the machinery and the original cost of the machinery sold.

Workings

Sale of Asset					

b. Calculate the amount paid for the new machinery.

Workings

Machinery					

Question 55

The following financial information has been located across an income statement, balance sheet and additional information.

- Loss on sale of motor vehicle was \$3,800.
- Accumulated depreciation of machinery sold was \$8,000.
- Carrying amount of machinery sold was \$10,000.
- Motor vehicle account opening balance was \$80,000.
- Motor vehicle account closing balance was \$105,000.

Required tasks:

a. Calculate the proceeds of sale of the machinery and the original cost of the machinery sold.

Workings

Sale of Asset					

b. Calculate the amount paid for the new machinery.

Workings

Motor Vehicles					

Reconstructions – Unearned Income / Income Received in Advance

When the balance sheet contains unearned income, the account must be reconstructed to find the cash received from fees. This appears in the SCF is by being added to the “Receipts from Customers” in the ‘Cash flows from operating activities’ section.

Example

Strange Tings Ltd has provided the following income statement and unclassified balance sheet. Entries relevant to the reconstruction of the unearned income account have been highlighted.

Strange Tings Ltd Income Statement (Extract) For the year ended 30 June 2029		
Fees		70,000
Less expenses		
Interest	300	
Rent	9,000	
Wages	4,200	
Discount allowed	400	
Depreciation of property, plant and equipment	7,000	20,900
Profit before Tax		49,100

Strange Tings Ltd Unclassified Balance Sheets As at 30 June 2029		
	30 June 2028	30 June 2029
Liabilities		
Unearned income	12,000	14,000

Required task:

Calculate the cash received from fees for the year ended 30 June 2029.

Solution

Unearned Income					
	Fees Income	70,000		Opening Balance	12,000
	Closing Balance	14,000		Bank	72,000
		84,000			84,000

Therefore, the cash received from customers is \$72,000 for the year ended 30 June 2029.

Reconstruction of unearned income purpose: The bank figure calculated when reconstructing the unearned income account is the cash received from customers. This appears in the SCF is by being added to the “Receipts from Customers” in the ‘Cash flows from operating activities’ section.

Practice Questions

Questions 56-58: Reconstructions – Unearned Income / Income Received in Advance.

Question 56

Bomboclat Pty Ltd has provided the following income statement and unclassified balance sheet.

Bomboclat Pty Ltd Income Statement (Extract) For the year ended 30 June 2047		
Fees		45,000
Less expenses		
Interest	500	
Rent	8,000	
Wages	11,500	
Discount allowed	700	
Depreciation of machinery	10,000	30,700
Profit before Tax		14,300

Bomboclat Pty Ltd Unclassified Balance Sheets As at 30 June 2047		
	30 June 2046	30 June 2047
Liabilities		
Unearned income	8,000	11,000

Required task:

a. Calculate the cash received from customers for the year ended 30 June 2047.

Unearned Income					
	Fees Income			Opening Balance	
	Closing Balance			Bank	

b. Describe the purpose of reconstructing unearned income.

Question 57

Black Wall Cliff Tours has provided the following income statement and unclassified balance sheet.

Black Wall Cliff Tours Income Statement (Extract) For the year ended 30 June 2040		
Fees		34,000
Less expenses		
Electricity	2,800	
Rent	6,300	
Wages	12,000	
Insurance	900	
Depreciation of equipment	1,200	23,200
Profit before Tax		10,800

Black Wall Cliff Tours Unclassified Balance Sheets As at 30 June 2040		
	30 June 2040	30 June 2039
Liabilities		
Unearned income	4,000	1,200

Required task:

a. Calculate the cash received from customers for the year ended 30 June 2040.

Unearned Income					

Question 58

Cat Silk has provided the following income statement and unclassified balance sheet.

Cat Silk Income Statement (Extract) For the year ended 30 June 2029		
Fees		31,500
Less expenses		
Advertising	1,200	
Wages	6,400	
Rent	5,000	
Insurance	700	
Depreciation of motor vehicle	2,000	15,300
Profit before Tax		16,200

Cat Silk Unclassified Balance Sheets As at 30 June 2029		
	30 June 2029	30 June 2028
Liabilities		
Unearned income	2,900	1,300

Required task:

a. Calculate the cash received from customers for the year ended 30 June 2029.

Unearned Income					

Reconstructions – Preparation of Statement of Cash Flows using Reconstructions

The following questions involve being given an income statement and two years of balance sheets. Reconstructions must then be performed to perform to calculate the cash flows that have occurred. Once these reconstructions have been calculated a SCF can be prepared. It is recommended to review the preparation of the SCF from the beginning of this chapter prior to attempting these questions.

Practice Questions

Questions 59-61: Reconstructions – Preparation of Statement of Cash Flows using Reconstructions.

- These questions use case studies from questions practiced in the above sections. These are good review to warm up and build confidence.
- After finishing these questions, it is recommended to practice the Cash Flows questions in the Exam Guide.

Exam Questions

See 'Cash Flows' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Tips	<p><u>Keeping track</u> Tick off each item on the BS and IS as you process these for the SCF. At the end there will be items not been ticked, which may help prompt to check if these relate to an item for the SCF.</p>
	<p><u>Nature of cash flows and reconstructions required for each section</u> A reminded of each of the cash flow categories and the reconstructions required for each section has been provided below as reference when completing practice questions.</p>
	<p><u>Example statement</u> An example Statement of Cash Flows has been provided as a reference to help during initial practice.</p>
	<p><u>Cash and cash equivalents at start and end of period</u> The cash and cash equivalents at the beginning or end of a period is made up of items on the balance sheet that are classified as cash and cash equivalents in year 1 (Start of period) or year 2 (end of period) respectively. In some questions this will simply be the year 2 cash at bank figure. In other questions this may need to be calculated.</p>

Cash Flows – Nature and reconstructions required for each section

Cash Flows	Nature	Reconstructions required to find cash flows
Operating activities	The principal revenue-producing activities of the entity and other activities that are not investing or financing activities.	Balance day adjustments for: <ul style="list-style-type: none"> • Income accounts. • Expense accounts.
Investing activities	The acquisition and disposal of long-term assets and other investments not included in cash equivalents.	<ul style="list-style-type: none"> • Non-Current Assets. • Accumulated Depreciation of Non-Current Assets. • Non-cash items are depreciation and carrying amount of non-current asset.
Financing activities	Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.	<ul style="list-style-type: none"> • Capital: transfers to/from reserves, capital increases/decreases, profit/loss. • Borrowings / loans.

Note: The nature of each activity section comes from AASB 107: Statement of Cash Flows.

Statement of Cash Flows – Statement Preparation

Key	<ul style="list-style-type: none"> • Green = positive figure. • Red = negative figure. • Grey = positive or negative • Blue = heading.
------------	--

Company Name Statement of Cash Flows for the year ended 30 June 20XX	
Cash flows from operating activities	
Receipts from customers	X
Payments to suppliers and employees	(X)
Interest paid (if for current liability)	(X)
Income tax paid	(X)
<i>Net cash from operating activities</i>	\$TOTAL
Cash flows from investing activities	
Interest received	X
Dividend received	X
Proceeds of sale of investments	X
Proceeds of sale of plant and equipment	X
Payment for Investments	(X)
Payment for NCA's / Purchase of NCA's	(X)
<i>Net cash from investing activities</i>	\$TOTAL
Cash flows from financing activities	
Proceeds from borrowings / loan	X
Share capital proceeds / Additional share capital	X
Debentures issued	X
Repayment of borrowings / loan	(X)
Repayment of debentures	(X)
Interest paid (if for non-current liability)	(X)
Dividends paid	(X)
Share issue costs	(X)
<i>Net cash from financing activities</i>	\$TOTAL
Net increase/decrease in cash held	X or (X)
Cash and cash equivalents at start of period	START
Cash and cash equivalents at end of period	START + net in/decrease

Tips	<ul style="list-style-type: none"> • Interest paid will either be within operating or financing activities depending on if it is for a current liability (operating) or a non-current liability (financing). • Interest received only belongs in the investing activities section based on AASB 107. I.e. Interest received from current and non-current both belong in the investing activities section. • Each NCA purchased or sold should have its own corresponding entry. • Dividends paid may also be classified as cash flows from operating activities. • Some of the wording in the above may vary slightly during exam questions. Read the exam question carefully and use wording for the entries that matches the wording of these entries in the question.
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Question 59

Chill Vibes has provided the following income statement and unclassified balance sheet.

Chill Vibes Income Statement For the year ended 30 June 2038		
Sales		700
Less sales returns		30
Less Cost of Sales		250
Gross Profit		420
Add Other Income		
Interest	40	
Discount received	30	
Gain on sale of property, plant and equipment	20	
Dividends	50	140
		560
Less Other Expenses		
Interest	30	
Advertising	9	
Other expenses	1	
Rent	60	
Doubtful debts	20	
Discount allowed	10	
Wages	20	
Depreciation of property, plant and equipment	40	190
Profit before Tax		370
Less Income tax expense		111
Profit after tax		259

Additional information:

- Proceeds from the sale of property, plant and equipment was \$50.
- Purchase returns for the year were \$10.
- Share issue costs during the period were \$1.

Chill Vibes Unclassified Balance Sheets As at 30 June 2038		
	30 June 2037	30 June 2038
Assets		
Cash at Bank	120	160
Accounts Receivable	40	50
Allowance for Doubtful Debts	(30)	(40)
Inventory	60	90
Prepaid rent	70	50
Accrued interest income	40	20
Investments (shares in companies)	150	150
Property, plant and Equipment	140	160
Less Accumulated Depreciation	(70)	(50)
Total Assets	520	590
Liabilities		
Accrued Wages	50	40
Income Tax Payable	10	20
Loan from Bank	0	60
Accounts Payable	20	30
Debentures	110	70
Total Liabilities	190	220
Equity		
Share Capital	150	160
General Reserve	110	90
Retained Earnings	70	120
Total Equity	330	370
Total Liabilities and Equity	520	590

Required task:

- Reconstruct the accounts necessary to prepare a Statement of Cash Flows for the year ended 30 June 2038.
- Prepare the Statement of Cash Flows for the year ended 30 June 2038.

Workings

Workings

Allowance for Doubtful Debts					

Accounts Receivable					

Therefore, the cash collected from customers was _____.

Inventory					

Accounts Payable					

Therefore, the cash paid for the purchase of inventory was _____.

Income Tax Payable					

Therefore, the income tax paid was _____.

General Reserve

Therefore, _____ has been transferred _____ retained earnings _____ the general reserve.

Retained Earnings					

Therefore, the dividend paid is _____.

Prepaid Rent					

Therefore, the rent expense paid is _____.

Share Capital					

Therefore, the share capital proceeds is _____.

Wages Expense					

Therefore, the wages expense paid was _____.

Interest Income					

Therefore, the interest income received is _____.

Accumulated Depreciation of Property, plant and equipment					

Sale of Asset					

Property, plant and equipment					

Therefore, the proceeds from sale of PPE were _____ and the cash paid for the new PPE were _____.

Question 60

Lo-Fi Hip Hop Radio Ltd has provided the following income statement and unclassified balance sheet.

Lo-Fi Hip Hop Radio Ltd Income Statement For the year ended 30 June 2043		
Sales		140
Less Cost of Sales		50
Gross Profit		90
Add Other Income		
Interest	5	
Discount received	4	
Dividends	7	16
		106
Less Other Expenses		
Interest	10	
Advertising	4	
Rent	15	
Wages	20	
Other expenses	20	
Depreciation of property, plant and equipment	7	76
Profit before Tax		30
Less Income tax expense		9
Profit after tax		21

Additional information:

- Proceeds from the sale of property, plant and equipment was \$20.
- The loss on sale of property, plant and equipment was \$5 (within Other expenses).
- Share issue costs during the period were \$3 (not on income statement as it is a closed account).

Lo-Fi Hip Hop Radio Ltd Unclassified Balance Sheets As at 30 June 2043		
	30 June 2042	30 June 2043
Assets		
Cash at Bank	155	145
Accounts Receivable	40	50
Inventory	30	34
Prepaid advertising	5	6
Accrued interest income	12	8
Investments (shares in companies)	25	25
Property, plant and Equipment	80	90
Less Accumulated Depreciation	(60)	(35)
Total Assets	287	323
Liabilities		
Accrued Interest	8	4
Income Tax Payable	14	19
Accounts Payable	50	40
Debentures	40	35
Total Liabilities	112	98
Equity		
Share Capital	55	87
General Reserve	30	50
Retained Earnings	90	88
Total Equity	175	225
Total Liabilities and Equity	287	323

Required task:

- Reconstruct the accounts necessary to prepare a Statement of Cash Flows for the year ended 30 June 2043.
- Prepare the Statement of Cash Flows for the year ended 30 June 2043.

Note:

- *Template ledgers have not been included in this question to replicate exam conditions. In exams students are only provided with blank working space and then blank lines for the final SCF.*

Hints:

- *Think back to the reconstructions you have completed throughout this chapter regarding which reconstructions must be completed. Double check if any balance sheet items have changed between year 1 and year 2 – these changes are also likely to correspond to an entry on the SCF.*
- *The loss on sale of equipment value appears on the income statement within the other expenses value. It is also given in the additional information.*

Workings

Workings

Question 61

Vogue Styles has provided the following income statement and unclassified balance sheet.

Vogue Styles Income Statement For the year ended 30 June 2038		
Sales		128
Less sales returns		16
Less Cost of Sales		61
Gross Profit		51
Add Other Income		
Interest	5	
Discount received	2	
Dividends	4	11
		62
Less Other Expenses		
Interest	1	
Insurance	3	
Rent	11	
Doubtful debts	4	
Selling and distribution expense	5	
Loss on sale of machinery	3	
Wages	4	
Depreciation of property, plant and equipment	12	43
Profit before Tax		19
Less Income tax expense		5.7
Profit after tax		13.3

Additional information:

- Proceeds from the machinery was \$15.
- Purchase returns for the year were \$6.
- Share issue costs were \$4.
- The loan from bank is due within 9 months.

Vogue Styles Unclassified Balance Sheets As at 30 June 2038		
	30 June 2038	30 June 2037
Assets		
Cash at Bank	144	148
Accounts Receivable	45	50
Allowance for Doubtful Debts	(6)	(5)
Inventory	28	25
Prepaid insurance	5	7
Accrued interest income	6	12
Investments	21	23
Machinery	70	60
Less Accumulated Depreciation	(29)	(40)
Total Assets	284	280
Liabilities		
Accrued selling and distribution expense	8	6
Income Tax Payable	5	3
Loan from Bank	3	0
Accounts Payable	55	60
Accrued wages	2	4
Debentures	18	26
Total Liabilities	91	99
Equity		
Share Capital	76	61
General Reserve	47	40
Retained Earnings	70	80
Total Equity	193	181
Total Liabilities and Equity	284	280

Required task:

a. Reconstruct the accounts necessary to prepare a Statement of Cash Flows for the year ended 30 June 2038.

Hint: In this question the year 1 and year 2 columns in the balance sheet have been swapped. Make sure to use the correct figure in reconstructions that do this.

b. Prepare the Statement of Cash Flows for the year ended 30 June 2038.

Exam Questions

See 'Cash Flows' chapter of the Exam Guide for practice exam questions. The Exam Guide can be found by navigating to the Resource Hub link on the front page.

Workings

Workings



Corporate Finance

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Make epic things happen as you rock the cash flow. You'll elevate, distribute, and skilfully manage business finances, all while being primed to seize investment opportunities that pop up.

Is it a good match for me?

If you have people skills, communication finesse, empathetic vibes, teamwork mojo, ability to problem-solve, and a love of understanding how businesses work – you're a tailor-made superstar for this career.

Where could I work?

Loads of large corporations like Disney, Sony, PepsiCo, and Kellogg's as well as financial services like HSBC and the biggest accounting firms.

How do I get there?

You don't need to study anything specific in high school, but business-related subjects can help you get a head start.

Ability to work overseas



Graduate salary*



*Hays Salary Guide FY23/24 Accounting and Finance

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20. Ratios



Activate Prior Knowledge

Respond to the following questions. Discuss your answers with a peer or the class.

<p>Which individuals or entities might be interested in the financial information of a business? Why?</p>	
<p>If you were looking to invest in a business, what would you like to know about it? Why?</p>	
<p>What could a given year of financial data for a business be compared to? What would this comparison show viewers?</p>	

Ratios

Recording, using and evaluating financial information: Recording, processing and communicating financial information

- preparation of the following ratios – application of GST **not** required
 - liquidity ratios
 - working capital/current
 - quick asset
 - efficiency ratios
 - debtor's collection
 - inventory/stock turnover
 - profitability ratios
 - profit
 - rate of return on assets
 - times interest earned
 - leverage ratio
 - debt to equity
 - market ratios
 - earnings per share
 - price/earnings
 - dividend yield

Note: Some of the below syllabus sections are in both the 'Ratios' chapter and 'Key Performance Indicators' chapter given the overlap in syllabus but distinctly different content/examination questions.

Recording, using and evaluating financial information: Evaluating financial information for planning, coordinating, controlling and investing

- examination and interpretation of annual reports, financial statements and stock exchange data to assess the position and performance of a public company
- purpose of annual reporting and the use of key performance indicators by directors for accountability and decision-making purposes
- interpretation of the following ratios:
 - liquidity ratios
 - working capital/current
 - quick asset
 - efficiency ratios
 - debtor's collection
 - inventory/stock turnover
 - profitability ratios
 - profit
 - rate of return on assets
 - times interest earned
 - leverage ratio
 - debt to equity
 - market ratios
 - earnings per share
 - price/earnings
 - dividend yield
- limitations in assessing performance from financial statement analysis and from traditional financial accounting
 - historical cost accounting
 - lack of comparability between entities
 - lack of disclosure

Ratios – Introduction

Ratios analyse various areas of a business to assess the performance of a company. Different ratios will measure different areas of performance. Once ratios have been calculated they can be compared with other information such as, budgeted ratio results, the ratio results of previous years, industry ratio averages or other businesses ratios. This chapter also discusses some of the possible limitations in assessing performance from ratios and traditional financial accounting.

Ratios analysis areas and specific ratios:

- Efficiency:
 - Debtor's Collection.
 - Inventory Turnover / Stock Turnover.
- Gearing / leverage / stability:
 - Debt to Equity Ratio.
- Liquidity:
 - Working Capital Ratio / Current Ratio.
 - Quick Asset Ratio / Acid Test Ratio.
- Profitability:
 - Profit Ratio.
 - Rate of Return on Assets Ratio.
 - Times Interest Earned.
- Market:
 - Earnings per share.
 - Price / Earnings.
 - Dividend Yield.

El Course Guide

See the El Course Guide – 'Ratio summary table' for all ratios summarised on one page. This will be useful for assessment revision regarding calculation and interpretation. The page following this summary table details essential theory you need to be familiar with beyond initial ratio calculation and interpretation. The Course Guide can be found by navigating to the Resource Hub link on the front page.

Tips

Rounding calculation results

The year 12 specification booklet states the result of ratio calculations should be given to two decimal places. Get in the habit of rounding to two decimal places while completing practice questions.

Question format

Assessment questions will often present a range of financial statements/information either in full statement format or as extracts of financial statements. Questions may then ask for calculation of specific ratios or give you ratio calculations. From here you must interpret what this ratio calculation means for an entity.

Using the specification booklet while practicing

Have the specification booklet open to refer to while completing practice questions from this book and the exam guide.

Specification book skills

Formulas for ratios are given to you in the exam. Once you are familiar with the overarching skills to calculate and interpret ratios, these can be applied to any ratio in conjunction with referring to information in the specification book. This is covered in the following 'Ratio Skill Check' section.

Labelling / using the specification booklet in the exam

The middle two columns of the below table are given to you in the specification book. It is recommended revising and writing in the far left and far right column during assessments or exams.

Tips

Analysis Area	Ratio	Method of Calculation	Result given
P (Profitability)	Profit	(In specification book)	X.XX %
E (Efficiency)	Debtor's Collection	(In specification book)	X.XX days
E (Efficiency)	Inventory/stock turnover	(In specification book)	X.XX times per year
L/G/S (Leverage / Gearing / Stability)	Debt to Equity	(In specification book)	X.XX %
L (Liquidity)	Working capital/current	(In specification book)	X.XX %
L (Liquidity)	Quick asset	(In specification book)	X.XX %
P (Profitability)	Rate of return on assets	(In specification book)	X.XX %
P (Profitability)	Times interest earned	(In specification book)	X.XX times
M (Market)	Earnings per share	(In specification book)	\$X.XX per share
M (Market)	Price/earnings	(In specification book)	X.XX times
M (Market)	Dividend yield	(In specification book)	X.XX times

The far left column will prompt you to remember which area each ratio belongs to. Often exams will ask you to analyse a ratio area for a company but the specification book only tells you the names of the ratio. Remembering these analysis areas will help you analyse the correct ratios. The order of the ratios in the specification booklet is similar to the grouping of the ratios in the Course Guide summary and the order they are covered in the Practical Guide. The exception is the profit ratio is not next to the other profit ratios. I.e., Write 'E' (short for Efficiency) next to debtor's collection and inventory/stock turnover, 'P' (for Profitability) next to 'Profit', 'rate of return on assets' and 'times interest earned' etc.

The far right column represents how to present your results. Given results are not just presented as percentages it is important to remember how to give results as this is worth marks. By revising and then writing in your specification booklet next to each of the ratios how to present your results, this should help you present your answers correctly and not miss out on marks.

Ratio Skill Check

Calculation and interpretation of ratios requires the ability to interpret:

- Movements in ratios as either positive or negative.
- Components that contribute to these movements.

This skill can be used in conjunction with the formulas provided in the specification sheet to greatly assist performance in exams.

<p>Ratio skill practice 1</p> <p>A non-specific ratio is given as below.</p> $\text{Ratio} = \frac{110}{100} \times 100$ <p>What does this ratio communicate to internal or external stakeholders?</p>	<p>Ratio skill practice 2</p> <p>A non-specific ratio is given as below.</p> $\text{Ratio} = \frac{80}{100} \times 100$ <p>What does this ratio communicate to internal or external stakeholders?</p>
---	--

<p>Solution 1</p> <p>110%</p> <p>This ratio demonstrates that when the result of a ratio is greater than 100%:</p> <ul style="list-style-type: none">• The top number of a ratio is higher than the bottom number.• If this top number were associated with something positive relative to the bottom number, then this ratio calculation would be a positive indicator of performance. This is because the top number (positive) is higher than the bottom number (negative).• If this top number were associated with something negative relative to the bottom number, then this ratio calculation would be a negative indicator of performance. This is because the top number (negative) is lower than the bottom number (positive).	<p>Solution 2</p> <p>80%</p> <p>This ratio demonstrates that when the result of a ratio is less than 100%:</p> <ul style="list-style-type: none">• The top number of a ratio is lower than the bottom number.• If this top number were associated with something positive relative to the bottom number, then this ratio calculation would be a negative indicator of performance. This is because the top number (positive) is lower than the bottom number (negative).• If this top number were associated with something negative relative to the bottom number, then this ratio calculation would be a positive indicator of performance. This is because the top number (negative) is higher than the bottom number (positive).
--	---

Ratio skill practice 3

	Year 1	Year 2
Ratio	52%	81%

What does this movement communicate to internal or external stakeholders?

Solution 3

80%

This ratio demonstrates that when the result of a ratio is less than 100% but is also increasing.

- The bottom number of a ratio is higher than the top number for both years.
- Between the two years, the top number has increased more than the bottom number. Alternatively, the bottom number has decreased less than the top number.
- If the top number were associated with something positive relative to the bottom number, then this ratio calculation would be a negative indicator of performance as it is less than 100%. However, the situation for the business has improved in Year 2 relative to Year 1.
- If the top number were associated with something negative relative to the bottom number, then this ratio calculation would be a positive indicator of performance as it is less than 100%. However, the situation has gotten worse in the second year.

Practice Questions

Questions 1-4: Ratio Skill Practice.

Tip

Course Guide

While completing this chapter you may find it useful to refer to the relevant chapter in the Essential Insight Course Guide. The Course Guide summarizes all theory relevant for each practical guide chapter. This saves time flipping through multiple pages in the Practical Guide while revising. The Course Guide can be found by navigating to the Resource Hub link on the front page.

Question 1

A hypothetical ratio is given below.

$$\text{Ratio} = \frac{230}{150} \times 100$$

Required tasks:

- Calculate the result of this ratio.
 - Is this movement positive or negative? Note: 230 represents assets and 150 represents liabilities.
-
-
-

Question 2

A ratio movement between two years is demonstrated below.

	Year 1	Year 2
Ratio	88%	124%

Required task:

- Is this ratio increasing or decreasing?

Question 3

A ratio movement between two years is demonstrated below.

	Year 2	Year 1
Ratio	92%	154%

Required task:

a. Is this ratio increasing or decreasing?

Question 4

A nonspecific ratio is given below.

$$\text{Ratio} = \frac{A+B}{C} \times 100$$

$$A = 50$$

$$B = 30$$

$$C = 90$$

Required tasks:

a. Calculate the ratio.

b. Is this result a positive or negative indicator for the business. Note: C is a positive indicator, relative to A and B.

Efficiency Ratios

Efficiency ratios measure the ability to manage inventory and accounts receivable. The efficiency ratios analysed are:

- Debtor's Collection.
- Inventory / Stock Turnover.

Debtor's Collection

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Efficiency	Ability to manage inventory and accounts receivable.	Debtor's Collection	Ability to collect accounts receivable from sales on credit.	$\frac{\text{Average Debtors}}{\text{Net Credit Sales}} \times 365$	<ul style="list-style-type: none"> • Decreased net credit sales. • Debts owed to business paid slower. • Accounts receivable should be managed better. • Need to develop internal control strategies for accounts receivable. 	<ul style="list-style-type: none"> • Increased net credit sales. • Debts owed to business paid sooner. • Accounts receivable is being managed better. • Internal control strategies for accounts receivable are more effective.

Example

Fish Max Income Statement (extract) as at 30 June 2043	
Credit Sales	187,000
Less Discount Allowed	3,600
Net Sales	183,400

Fish Max Balance Sheet (extract) as at 30 June 2043		
	30 June 2042	30 June 2043
Accounts Receivable	25,300	28,500
Allowance for Doubtful Debts	2,500	2,800

Additional information:

- The debtor's collection period was 45.79 days in 2042.

Required task:

Calculate debtor's collection for the financial year. Evaluate the efficiency of Fish Max by using the debtor's collection.

Solution

Step 1 – Calculate average debtors.

Average debtors is found by adding the current and the previous financial year's debtors (accounts receivable) and dividing the total by two. Average debtors does not subtract the allowance for doubtful debts

$$\begin{aligned} \text{Average debtors} &= (25,300 + 28,500) / 2 \\ &= 26,900 \end{aligned}$$

Step 2 – Calculate debtor's collection period for the financial year.

$$\text{Debtor's Collection} = \frac{\text{Average Debtors}}{\text{Net Credit Sales}^B} \times \frac{365}{1}$$

B: Net Sales = Sales Revenue – Sales returns and allowances – Discount allowed

$$\begin{aligned} \text{Debtor's Collection} &= 26,900 / (187,000 - 3,600) \times 365 \\ &= (26,900 / 183,400) \times 365 \\ &= 53.54 \text{ days} \end{aligned}$$

Step 3 – Evaluate the debtor's collection period.

When interpreting a ratio, first define the ratio.

The debtor's collection period indicates the ability of a business to collect accounts receivable from sales on credit.

Next, state the ratio for each year and identify whether this has increased or decreased.

The debtor's collection period has increased from 45.79 days in 2042 to 53.54 days in 2043.

The ratio is then interpreted.

This increase is negative and indicates the following may have occurred:

- Decreased net credit sales.
- Debts owed to business paid slower.
- Accounts receivable should be managed better.
- Need to develop internal control strategies for accounts receivable.

Practice Questions

Questions 5-6: Debtor's Collection Ratio.

$$\text{Debtor's Collection} = \frac{\text{Average Debtors}}{\text{Net Credit Sales}^B} \times \frac{365}{1}$$

B: Net Sales = Sales Revenue – Sales returns and allowances – Discount allowed

Question 5

Question	Average Debtors	Net Credit Sales	Debtor's Collection
a	\$12,000	\$10,000	$(12,000 / 10,000) \times 365$ = 438 days
b	\$2,800	\$3,300	
c	\$1,500	\$9,000	
d	Debtors at start of period: \$3,200 Debtors at end of period: \$4,500	Credit Sales Revenue: 16,000 Sales Returns: 500	
e	Debtors at start of period: \$22,000 Debtors at end of period: \$18,000	Credit Sales Revenue: \$183,000 Discount allowed: \$5,800	

Question 6

Question	Debtor's Collection		Increasing or decreasing?
	Year 1	Year 2	
a	18 days	20 days	
b	34 days	23 days	
c	24 days	25 days	

d. Describe three interpretations of this ratio increasing.

e. Describe three interpretations of this ratio decreasing.

Inventory Turnover / Stock Turnover

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Efficiency	Ability to manage inventory and accounts receivable.	Inventory / Stock Turnover	Number of times inventory replaced each period.	$\frac{\text{Cost of Sales}}{\text{Cost of Average Inventory}}$ <p>Answer = x times per period</p>	<ul style="list-style-type: none"> Increasing cost of sales relative to cost of average inventory. Quick inventory sales. High cash flow as a result of high sales. Less stock wastage. Could imply stock not being refilled. Don't want it too high because of restocking issues. 	<ul style="list-style-type: none"> Decreasing cost of sales relative to cost of average inventory. Slow inventory sales. Low cash flow as a result of low sales. High stock wastage. Could imply recent/high stock refill. Strategies needed to increase sales.

Example

Fish Max Income Statement (extract) as at 30 June 2032		
Net Sales		87,000
Less Cost of Sales	29,200	
Cartage Inwards	1,400	
Import taxes	400	
Discount Received	300	31,300
Gross Profit		55,700

Additional information:

- Inventory was \$19,000 as at 30 June 2031 and \$25,000 as at 30 June 2032.
- The inventory/stock turnover was 2.43 times per year in 2031.

Required task:

Calculate inventory turnover for the year ended 30 June 2032.

Solution

Step 1 – Calculate cost of average inventory.

Note: Cost of average inventory formula is not provided in the specification booklet.

$$\text{Cost of average inventory} = \frac{\text{Opening Inventory} + \text{Closing Inventory}}{2}$$

Cost of average inventory:

$$= (19,000 + 25,000) / 2$$

$$= 22,000$$

Step 2 – Calculate cost of sales.

Note: Cost of sales formula is provided in the specification booklet.

$$\text{Cost of sales (total)} = \text{Cost of sales (account)} + \text{Import duties} + \text{Freight inwards} - \text{Discount received}$$

$$= 29,200 + 1,400 + 400 - 300$$

$$= 30,700$$

Step 3 – Calculate inventory / stock turnover.

$$\text{Inventory/stock turnover} = \frac{\text{Cost of Sales } ^c}{\text{Cost of average inventory}}$$

Inventory / stock turnover

$$= 30,700 / 22,000$$

$$= 1.395. \text{ This is rounded up to } 1.40 \text{ times per year}$$

Therefore, Fish Max turns over inventory 1.40 times per year or approx. every 8.57 months (12 months / 1.42).

Step 4 – Evaluate the inventory/stock turnover.

The inventory/stock turnover ratio indicates the number of times inventory is replaced each period.

The inventory/stock turnover has decreased from 2.43 times per year in 2031 to 1.40 times per year in 2032. This decrease is negative, and the following may have occurred:

- Decreasing cost of sales relative to cost of average inventory
- Slow inventory sales.
- Low cash flow as a result of low sales.
- High stock wastage.
- Low number could imply recent/high stock refill.
- Strategies needed to increase sales.

Practice Questions

Questions 7-8: Inventory/stock turnover.

Questions 9-10: All Efficiency Ratios.

$$\text{Inventory/stock turnover} = \frac{\text{Cost of Sales } ^C}{\text{Cost of average inventory}}$$

C: Cost of sales (total) = Cost of sales (account) + Import duties + Freight inwards – Discount received

Question 7

Question	Cost of Sales	Cost of Average Inventory	Inventory/stock turnover
a	2,800	1,200	$\frac{2,800}{1,200}$ = 2.33 times per year
b	18,300	9,800	
c	800	250	
d	Cost of Sales: 1,500 Freight Inward: 180	Inventory at start of year: 500 Inventory at end of year: 600	
e	Cost of Sales: 8,900 Discount Received: 600	Inventory at start of year: 1,500 Inventory at end of year: 2,200	

Question 8

Question	Inventory/stock turnover		Increasing or decreasing?
	Year 1	Year 2	
a	2.23 times per year	3.62 times per year	
	2030	2029	Increasing or decreasing?
b	6.75 times per year	8.23 times per year	
	2032	2033	Increasing or decreasing?
c	2.61 times per year	2.40 times per year	

d. Describe three interpretations of this ratio increasing.

e. Describe three interpretations of this ratio decreasing.

Question 10

Infinity Tech develops apps for clients. The following trial balance was prepared prior to construction of a statement of financial position and statement of comprehensive income.

Infinity Tech
Trial balance (extracts) for the years ended 2030 and 2031

	30 June 2029	30 June 2030	30 June 2031
Credit Sales	210,000	250,000	290,000
Sales returns and allowances	2,300	2,600	2,800
Discount allowed	7,200	9,100	10,700
Cost of Sales	260,000	280,000	295,000
Inventory	80,000	92,000	94,000
Import taxes	4,000	4,500	4,900
Discount received	8,000	7,500	7,800
Freight inwards	10,000	11,000	11,700
Accounts Receivable	52,000	56,000	45,000

Required tasks:

a. Calculate the Debtors Collection period for 2030 and 2031.

Workings

b. Calculate the Inventory Turnover / Stock Turnover for 2030 and 2031.

Workings

Gearing / Leverage / Stability Ratios

Gearing ratios measure the ability of a business to survive long term. Gearing ratios compare internal debt (equity) with external debt (liabilities). The gearing ratio analysed is:

- Debt to Equity Ratio.

Debt to Equity Ratio

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Gearing / Leverage / Stability	Ability of a business to survive long term - comparison of internal debt (equity) with the external debt (liabilities).	Debt to Equity Ratio	Ability of a business to survive long term.	Total Liabilities	<ul style="list-style-type: none"> • Over 100% or 1.0:1.0 not ideal as this indicates high external finance reliance relative to owner's equity. • Increased liabilities. • Decreased owner's equity. • Concern that high interest rates increase debt repayments. 	<ul style="list-style-type: none"> • 100% or 1.0:1.0 or less ideal as this indicates not too much external finance reliance relative to owner's equity. • Decreased liabilities. • Increased owner's equity. • Less concern of high interest rates due to debt repayment implications.
				Equity (End)		

Example

Flow Mindfulness Ltd has provided the following balance sheet extract.

Flow Mindfulness Ltd Balance Sheet (extract) As at 30 June 2045	
Total Assets	201,000
Total Liabilities	106,000
Total Equity	95,000

Additional information:

- The debt to equity ratio in 2044 was 105.26%.

Required task:

Assess the gearing of Flow Mindfulness Ltd in 2045.

Solution

Step 1 – Calculate debt to equity ratio.

Gearing is assessed by calculating the debt to equity ratio.

$$\text{Debt to equity} = \frac{\text{Total liabilities}}{\text{Equity (end)}} \times 100$$

$$\begin{aligned} \text{Debt to equity ratio} &= 106,000 / 95,000 \\ &= 111.58\% \end{aligned}$$

Step 2 – Interpret the debt to equity ratio.

The debt to equity ratio indicates the ability of a business to survive long term.

The debt to equity ratio has increased from 105.26% in 2044 to 111.58% in 2045.

The debt to equity ratio being over 100% is not ideal as this indicates high external finance reliance relative to owner's equity.

The debt to equity ratio increasing indicates the following may have occurred:

- Increased liabilities.
- Decreased owner's equity.
- The business may be concerned that high interest rates may increase debt repayments.

Practice Questions

Questions 11-14: Gearing / Leverage / Stability Ratio.

$$\text{Debt to equity} = \frac{\text{Total liabilities}}{\text{Equity (end)}} \times 100$$

Question 11

Question	Total liabilities	Equity	Debt to equity
a	\$40,000	\$50,000	$40,000 / 50,000$ = 80%
b	\$68,000	\$56,000	
c	\$120,500	\$250,000	
d	\$1,430	\$900	
e	\$12,000	\$8,080	

Question 12

Question	Debt to equity		Increasing or decreasing?
	Year 1	Year 2	
a	93%	28%	
	2030	2029	Increasing or decreasing?
b	70%	80%	
	2032	2033	Increasing or decreasing?
c	42%	49%	

d. Describe three interpretations of this ratio increasing.

e. Describe three interpretations of this ratio decreasing.

Question 13

You are interested in investing in a sustainable energy company developing infrastructure in Western Australia and have narrowed your investment decision down to two companies – Horizon Wave and Green Bolt. The below financial information for the most recent financial year has been located in the annual report of each company.

Statements of Financial Position as at 30 June 2024		
	Horizon Wave \$ (000)	Green Bolt \$ (000)
Assets		
Cash	13	120
Receivables	32	36
Inventories	90	53
Property, plant and equipment	250	505
Total assets	385	714
Liabilities		
Payables	42	87
Borrowings	170	260
Total liabilities	212	347
Equity		
Ordinary share capital	120	340
Retained earnings	53	27
Total equity	173	367
Total liabilities and equity	385	714

Required tasks:

a. Calculate the debt to equity ratio for Horizon Wave and Green Bolt.

Workings

Question 14

Esperance Farm Supplies has provided the following financial information for the year ended 30 June 2043.

Esperance Farm Supplies Balance sheet (extract) as at 30 June 2043	
Current assets	
Cash	45,000
Accounts Receivable	14,000
Inventory	63,000
Total current assets	122,000
Non-current assets	
Motor Vehicles	40,000
Land	130,000
Total non-current assets	170,000
Total assets	292,000
Current liabilities	
Accounts payable	31,000
Total current liabilities	31,000
Non-current liabilities	
Mortgage	140,000
Total non-current liabilities	140,000
Total liabilities	171,000

Ratio	2041	2042	2043
Debt to equity ratio	81.14	116.65	

Required tasks:

a. Calculate the debt to equity ratio for the year 2043.

Workings

Liquidity Ratios

Liquidity ratios measure the ability of a business to pay due debts. The liquidity ratios analysed are:

- Working capital ratio.
- Quick asset ratio.

Working Capital Ratio / Current Ratio

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Liquidity	Ability of a business to pay due debts.	Working Capital Ratio / Current Ratio	Ability to pay short-term debts.	Current Assets	<ul style="list-style-type: none"> • Between 100-200% or 1.0-2.0:1.0 ideal – Indicates capacity to pay short term debts. • Current assets increasing relative to current liabilities. • Decreased creditors or current liabilities. • Cash may be idle that could be invested. • Slower debtor receipts. 	<ul style="list-style-type: none"> • Less than 100% or 1.0:1.0 not ideal – Indicates possible short term debt repayment issues. • Decreasing current assets relative to current liabilities. • Increased creditors or current liabilities. • Cash has been invested rather than sitting idle. • Fast debtor receipts
				Current Liabilities		

Example

Neuro Co Pty Ltd. Balance Sheet (extract) As at 30 June 2025	
Current Assets	
Cash at Bank	14,000
Inventory	35,000
Prepaid Insurance	3,000
Prepaid Rent	4,000
Total Current Assets	56,000
Current Liabilities	
Bank Overdraft	3,000
Unearned income	4,000
Accounts Payable	29,000
Accrued Expenses	6,000
Total Current Liabilities	42,000

The working capital ratio for 2024 was 125.21%.

Required task:

Assess the liquidity of Neuro Co Pty Ltd. using the working capital ratio.

Solution

Step 1 – Calculate the working capital ratio.

$$\text{Working capital/current} = \frac{\text{Current assets}}{\text{Current liabilities}} \times 100$$

$$\text{Working capital} = 56,000 / 42,000 \\ = 133.33\%$$

Step 2 – Evaluate the working capital ratio.

The working capital ratio indicates the ability of a business to pay short-term debts.

The working capital ratio has increased from 125.21% in 2024 to 133.33% in 2025.

Between 100-200% is ideal as it indicates capacity to pay short term debts.

This increase is positive and may have been caused by:

- Current assets increasing relative to current liabilities.
- Cash may be idle that could be invested.
- Slower debtor receipts.
- Decreased creditors or current liabilities.

Practice Questions

Questions 15-16: Working Capital / Current Ratio.

$$\text{Working capital/current} = \frac{\text{Current assets}}{\text{Current liabilities}} \times 100$$

Question 15

Question	Current assets	Current liabilities	Working capital/current
a	\$1,400	\$900	$\frac{1,400}{900}$ = 155.56%
b	\$800	\$1,200	
c	\$15,000	\$23,000	
d	\$240,500	\$90,800	
e	\$950	\$430	

Question 16

Question	Working capital/current		Increasing or decreasing?
	Year 1	Year 2	
a	64%	112%	
	2028	2029	Increasing or decreasing?
b	83%	84%	
	2042	2041	Increasing or decreasing?
c	120%	113%	

d. Describe three interpretations of this ratio increasing.

e. Describe three interpretations of this ratio decreasing.

Quick Asset Ratio / Acid Test Ratio

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Liquidity	Ability of a business to pay due debts.	Quick Asset Ratio / Acid Test Ratio	Ability to use highly liquid assets to pay urgent short term debts.	$\frac{\text{Current Assets (excluding inventory and prepayments)}}{\text{Current Liabilities (except for Bank Overdraft)}}$	<ul style="list-style-type: none"> • Ideally above 100% or 1.0:1.0 implies short term debt is payable. • Increasing current assets such as cash. • Increasing debtors. • Decreasing creditors. 	<ul style="list-style-type: none"> • Below 100% or 1.0:1.0 implies short term debt might not be payable. • Decreasing current assets such as cash. • Decreasing debtors. • Increasing creditors.

Example

Neuro Co Pty Ltd. Balance Sheet (extract) As at 30 June 2025	
Current Assets	
Cash at Bank	14,000
Inventory	35,000
Prepaid Insurance	3,000
Prepaid Rent	4,000
Total Current Assets	56,000
Current Liabilities	
Bank Overdraft	3,000
Unearned income	4,000
Accounts Payable	29,000
Accrued Expenses	6,000
Total Current Liabilities	42,000

Additional information:

- The quick asset ratio for 2024 was 25.10%.

Required task:

Assess the liquidity of Neuro Co Pty Ltd. using the quick asset ratio.

Solution

Step 1 – Calculate the quick asset ratio.

$$\text{Quick asset} = \frac{\text{Current assets (excluding inventory and prepayments)}}{\text{Current liabilities (excluding bank overdraft)}} \times 100$$

Quick asset ratio:

$$\begin{aligned}
 &= (56,000 - 35,000 - 3,000 - 4,000) / (42,000 - 3,000) \times 100 \\
 &= (14,000 / 39,000) \times 100 \\
 &= 35.90\%
 \end{aligned}$$

Step 2 – Interpret the quick asset ratio.

The quick asset ratio indicates the ability of a business to use highly liquid assets to pay urgent short term debts.

The quick asset ratio increased from 25.10% in 2024 and 35.90% in 2025.

Ideally this ratio should be above 100%. As the ratio is below 100%, this implies short term debt might not be payable. However, it is positive that the ratio has increased as this indicates the following may have occurred:

- Increasing debtors.
- Decreasing creditors.
- Increasing current assets such as cash.

Practice Questions

Questions 17-18: Quick Asset Ratio.

Questions 19-20: All Liquidity Ratios.

$$\text{Quick asset} = \frac{\text{Current assets (excluding inventory and prepayments)}}{\text{Current liabilities (excluding bank overdraft)}} \times 100$$

Question 17

Question	Current assets (excluding inventory and prepayments)	Current liabilities (excluding bank overdraft)	Quick asset
a	\$25,000	\$30,000	25,000 / 30,000 = 83.33%
b	\$36,000	\$18,000	
c	\$1,500	\$1,200	
d	Current Assets: \$18,500 Inventory: \$3,000	Current liabilities: \$7,000	
e	Current Assets: \$4,300 Prepaid advertising: \$200 Prepaid rent: \$500	Current liabilities: \$3,500 Bank overdraft: \$150	

Question 18

Question	Quick asset		Increasing or decreasing?
	Year 1	Year 2	
a	115%	120%	
	2018	2017	Increasing or decreasing?
b	112%	123%	
	2020	2021	Increasing or decreasing?
c	88%	93%	

d. Describe three interpretations of this ratio increasing.

e. Describe three interpretations of this ratio decreasing.

Practice Questions

Questions 19-20: All Liquidity Ratios.

$$\text{Working capital/current} = \frac{\text{Current assets}}{\text{Current liabilities}} \times 100$$

$$\text{Quick asset} = \frac{\text{Current assets (excluding inventory and prepayments)}}{\text{Current liabilities (excluding bank overdraft)}} \times 100$$

Question 19

The following information has been provided about 'East Six Seven Ltd'.

East Six Seven Ltd	
Statement of financial position	
For the year ended 30 June 2029	
Current assets	
Cash and cash equivalents	56,000
Trade and other receivables	121,000
Inventories	115,000
Financial assets	46,000
Other current assets	7,000
Total current assets	345,000
Non-current assets	
Property, plant and equipment	250,000
Total non-current assets	250,000
Total assets	595,000
Current liabilities	
Trade and other payables	290,000
Tax payable	90,000
Total current liabilities	380,000
Non-current liabilities	
Long term borrowings	65,000
Total non-current liabilities	65,000
Total liabilities	445,000
Net assets	
Equity	
Share capital	120,000
Retained earnings	30,000
Total equity	150,000

Additional information:

- Other current assets consist of prepaid rent and prepaid advertising.
- The trial balance had an entry for cash at bank in credit for \$8,000.

Required tasks:

a. Identify and calculate two ratios to provide a measure of East Six Seven Ltd's liquidity.

Workings

Profitability Ratios

Profitability ratios measure the ability to create profits from investment in assets or equity. The profitability ratios analysed are:

- Profit ratio.
- Rate of return on assets ratio.
- Times interest earned.

Profit Ratio

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Profitability	Ability to create profits from investment in assets or equity.	Profit Ratio	Profit percentage within each sale.	Profit (after income tax)	<ul style="list-style-type: none"> • Increasing profit relative to sales/fees • Decreasing expenses. • Sale of more high profit stock relative to low profit stock. • Less depreciation of NCAs due to less capital investment. • More accrued income received. 	<ul style="list-style-type: none"> • Decreasing profit relative to sales/fees. • Increasing expenses. • Sale of less high profit stock relative to low profit stock. • More depreciation of NCAs via recent capital investment. • Less accrued income received.
				Total revenue (or Net Sales or Fees)		

Example

CX2 Construction Ltd Statement of Comprehensive Income for the year ended 30 June 2036	
Profit before tax	43,200
Less income tax	12,960
Profit after tax	30,240

Additional information:

- Total revenue for 2036 was \$255,000.
- The profit ratio for 2035 was 9.27%.

Required task:

Evaluate the profit ratio for CX2 construction.

Solution

Step 1 – Calculate the profit ratio.

$$\text{Profit} = \frac{\text{Profit (after income tax)}^A}{\text{Total revenue}} \times 100$$

Total revenue = Sales revenue – Sales returns and allowances – Discount allowed

Note: In this question Total Revenue has been provided in the question. In some questions you may need to calculate Total Revenue.

$$\begin{aligned}\text{Profit} &= 30,240 / 255,000 \\ &= 11.86\%\end{aligned}$$

Step 2 – Evaluate the profit ratio.

The profit ratio indicates the profit percentage within each sale.

The profit ratio increased from 9.27% in 2035 to 11.86% in 2036.

This increase is positive, and the following may have occurred:

- Increasing profit relative to sales/fees.
- Decreasing expenses.
- Sale of more high profit stock relative to low profit stock.
- Less depreciation of NCA due to less capital investment.
- More accrued income received.

Practice Questions

Questions 21-22: Profit Ratio.

$$\text{Profit} = \frac{\text{Profit (after income tax)}^A}{\text{Total revenue}} \times 100$$

A: Income tax is to be charged at the specific company rate.

Question 21

Question	Profit (after income tax)	Total revenue	Profit Ratio
a	\$100	\$1,000	100 / 1000 = 10%
b	\$1,200	\$15,000	
c	\$23,000	\$125,000	
d	Profit: 10,000 Income Tax: 3,000	Net Sales: \$82,000 Discount allowed: \$2,000	
e	Profit: 25,000 Income Tax: 7,500	Net Sales: \$115,000 Sales returns: \$5,000	

Question 22

Question	Profit		Increasing or decreasing?
	Year 1	Year 2	
a	15.13%	12.64%	
	2023	2022	Increasing or decreasing?
b	9.12%	8.52%	
	2032	2033	Increasing or decreasing?
c	6.02%	12.36%	

d. Describe three interpretations of this ratio increasing.

e. Describe three interpretations of this ratio decreasing.

Rate of Return on Assets Ratio

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing.
Profitability	Ability to create profits from investment in assets or equity.	Rate of Return on Assets Ratio	The efficiency of using assets to generate profit.	$\frac{\text{Profit before income tax} + \text{Interest expense}}{\text{Average total assets}}$	<ul style="list-style-type: none"> Increasing profit relative to assets. More efficient asset use to generate higher returns. 	<ul style="list-style-type: none"> Decreasing profit relative to assets. Less efficient asset use to generate returns.

Example

Note: The information to calculate the rate of return on assets will normally be found on the statement of comprehensive income and the statement of financial position. For ease of calculation for this initial example, the numbers necessary to calculate the rate of return on asset are provided on a trial balance over two years.

Anime Power Ltd Trial balance (extract)		
	30 June 2035	30 June 2036
Profit before income tax	18,000	11,400
Interest expense	1,200	5,700
Total assets	63,000	75,000

Additional information:

- The rate of return on assets was 32.72% in 2035.

Required task:

Evaluate the rate of return on assets for Anime Power Ltd.

Solution

Step 1 – Calculate the average total assets.

Note: the average total assets formula is not provided in the specification booklet.

$$\text{Average total assets} = \frac{\text{Assets start of year} + \text{Assets end of year}}{2}$$

$$\begin{aligned} \text{Average total assets} &= (63,000 + 75,000) / 2 \\ &= \$69,000 \end{aligned}$$

Step 2 – Calculate the rate of return on assets.

$$\text{Rate of Return on Assets} = \frac{\text{Profit before income tax} + \text{Interest expense}}{\text{Average total assets}} \times 100$$

$$\begin{aligned} \text{Rate of return on assets} &= (11,400 + 5,700 / 69,000) \times 100 \\ &= 24.78\% \end{aligned}$$

Step 3 – Evaluate the rate of return on assets.

The rate of return on assets ratio indicates the efficiency of using assets to generate profit.

The rate of return on assets has decreased from 32.72% in 2035 to 24.78% in 2036.

This decrease is negative and can be interpreted as:

- Decreasing profit relative to assets.
- Less efficient asset use to generate returns.

Practice Questions

Questions 23-24: Rate of Return on Assets Ratio.

$$\text{Rate of Return on Assets} = \frac{\text{Profit before income tax} + \text{Interest expense}}{\text{Average total assets}} \times 100$$

Question 23

Question	Profit before income tax + Interest expense	Average total assets	Rate of Return on Assets
a	\$1,100	\$10,000	$1,100 / 10,000 = 11\%$
b	\$550	\$3,800	
c	\$4,300	\$56,000	
d	Profit before income tax: \$300 Interest expense: \$400	Total assets start of year: \$5,000 Total assets end of year: \$5,200	
e	Profit before income tax: \$2,000 Interest expense: \$100	Total assets start of year: \$12,000 Total assets end of year: \$15,000	

Question 24

Question	Rate of Return on Assets		Increasing or decreasing?
	Year 1	Year 2	
a	13.23%	11.10%	
	2056	2055	Increasing or decreasing?
b	8.92%	6.43%	
	2032	2033	Increasing or decreasing?
c	9.32%	9.23%	

d. Describe two interpretations of this ratio increasing.

e. Describe two interpretations of this ratio decreasing.

Times Interest Earned

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Profitability	Ability to create profits from investment in assets or equity.	Times Interest Earned	How many times business interest is covered by profit before tax.	$\frac{\text{Profit before income tax} + \text{Interest expense}}{\text{Interest expense}}$	<ul style="list-style-type: none"> • Interest payments able to be made. • Low leverage (indicated by low interest expense from loans). • Investment should be considered if very high (due to high profit relative to interest expense). 	<ul style="list-style-type: none"> • Interest payments may be difficult to make. • High leverage (indicated by high interest expense from loans). • Investment should not be considered if low (due to low profit relative to interest expense).

Example

The information required to calculate times interest earned would normally be found on the income statement. Information required for this ratio has been provided in a trial balance for demonstration purposes.

Outdoor Galore Trial balance As at 30 June 2018	
Interest Expense	3,800
Profit before income tax	28,500
Less income tax expense	8,550
Profit after income tax	19,950

Additional information:

- The times interest earned for 2017 was 9.2 times.

Required task:

Evaluate the times interest earned of Outdoor Galore for 2018.

Solution

Step 1 – Calculate the times interest earned.

$$\text{Times Interest Earned} = \frac{\text{Profit before income tax} + \text{Interest expense}}{\text{Interest expense}}$$

$$\text{Times interest earned} = [(28,500 + 3,800) / 3,800]$$

$$= 8.5 \text{ times}$$

Therefore, the times interest earned is 8.5 times.

Step 2 – Evaluate the times interest earned.

The times interest earned ratio indicates how many times business interest is covered by profit before tax.

The times interest earned has decreased from 9.2 times in 2017 to 8.5 times in 2018.

This number is high which is a positive indication that the business's interest expense is covered by profit before tax. However, because this is decreasing, this may indicate:

- Interest payments may be increasingly difficult to make.
- High leverage.
- Investment should not be considered if low.

Practice Questions

Questions 25-26: Times Interest Earned Ratio.

Questions 27-28: All Profitability Ratios.

$$\text{Times Interest Earned} = \frac{\text{Profit before income tax} + \text{Interest expense}}{\text{Interest expense}}$$

Question 25

Question	Profit before income tax + Interest expense	Interest expense	Times Interest Earned
a	6,000	500	6,000 / 500 = 12 times
b	7,800	3,500	
c	127,000	34,800	
d	Profit before income tax: 15,200 Interest expense: 2,700	2,700	
e	Profit before income tax: 65,000 Interest expense: 11,300	11,300	

Question 26

Question	Times Interest Earned		Increasing or decreasing?
	Year 1	Year 2	
a	8.62 times	10.29 times	
	2051	2052	Increasing or decreasing?
b	8.25 times	3.53 times	
	2035	2034	Increasing or decreasing?
c	9.53 times	6.31 times	

d. Describe three interpretations of this ratio increasing.

e. Describe three interpretations of this ratio decreasing.

Question 27

Using the financial information provided, evaluate the following ratios for 'Lateesha's Heataz' as at 30 June 2024 and 30 June 2025.

Lateesha's Heataz Trial balance (extracts)		
	As at 30 June 2024	As at 30 June 2025
Profit	160,700	185,200
Interest received	3,400	6,200
Interest expense	23300	25500
Revenue	213,000	225,100
Gain on asset revaluation	12,000	47,000
Advertising expense	10,320	11,840
Total assets	920,000	945,000

Additional Information:

- Income tax is charge at 30% of profit.
- Total Assets as at 30 June 2023 was 892,000.
- Depreciation on motor vehicle in 2025 was \$14,980.
- Doubtful debts of \$3650 were written off as bad debts.

Required tasks:

Using the financial information provided, evaluate the following ratios for 'Lateesha's Heataz' as at 30 June 2024 and 30 June 2025.

- a. Profit ratio.
- b. Rate of Return on Assets.
- c. Times Interest Earned.

a. Profit ratio

Workings

b. Rate of Return on Assets.

Workings

c. Times Interest Earned.

Workings

Market Ratios

Market ratios Review ASX performance of public companies. The market ratios analysed are:

- Earnings per share.
- Price / earnings.
- Dividend yield.

Earnings Per Share

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Market	Review ASX performance of public companies.	Earnings Per Share	Amount of profit after tax a company earns relative to the number of ordinary shares.	Profit after income tax	<ul style="list-style-type: none"> • Higher return for shareholders. • Higher profit per share. 	<ul style="list-style-type: none"> • Lower return for shareholders. • Lower profit per share.
				Weighted average number of ordinary shares issued		

Example

Golden Dawn Gaming Ltd Statement of Comprehensive Income (extract) for the year ended 30 June 2019		
	2018	2019
Profit before income tax	12,400	13,500
Less income tax	3,720	4,050
Net profit after tax	8,680	9,450

Additional information

- 30,000 ordinary shares were issues for 215 days in the days during the year ended 30 June 2019.
- 50,000 ordinary shares were issued for 48 days in the year during the year ended 30 June 2019.
- The earnings per share in 2018 was 32 cents per share.

Required task:

Evaluate the earnings per share for Golden Dawn Gaming Ltd for the year ended 30 June 2019.

Solution

Step 1 – Calculate the weighted number of ordinary shares issued.

Note: this formula is not provided in the specification booklet.

$$\text{Weighted average number of ordinary shares issued} = \frac{\text{Number of days shares issued}}{365} \times \frac{\text{Number of shares issued}}{1} \times 100$$

The equation to the right of the equals sign is repeated for each share issue and then these are added together. This is demonstrated below.

Weighted average number of ordinary shares issued:

$$= [(215 / 365) \times 30,000] + [(48 / 365) \times 50,000]$$

$$= 17,671.23 + 6,575.34$$

$$= 24,246.57$$

Step 2 – Calculate the earnings per share.

$$\text{Earnings Per Share} = \frac{\text{Profit (after income tax)}}{\text{Weighted average number of ordinary shares issued}} \times 100$$

$$\text{Earnings per share} = (9,450 / 24,246.57) \times 100$$

$$= 38.97 \text{ cents per share OR } \$0.39 \text{ per share}$$

Step 3 – Evaluate the earnings per share.

The earnings per share ratio indicates the amount of profit after tax a company earns relative to the number of ordinary shares.

The earnings per share increased from \$0.32 per share in 2018 to \$0.39 per share in 2019. This increase is positive and indicates:

- Higher return for shareholders.
- Higher profit per share.

Practice Questions

Questions 29-30: Earnings Per Share Ratio.

$$\text{Earnings Per Share} = \frac{\text{Profit (after income tax)}}{\text{Weighted average number of ordinary shares issued}} \times 100$$

Question 29

Question	Profit (after income tax)	Weighted average number of ordinary shares issued	Earnings Per Share
a	5,600	42,000	$5,600 / 42,000$ = \$0.13 per share <i>Note: the result is already in dollars before multiplying the workings by 100 so the result does not need to be multiplied by 100. Multiplying the result by 100 would give the result in cents per share rather than dollars per share.</i>
b	880	5,100	
c	Profit: 250,000 Income tax: 75,000	600,000	
d	600	10,000 ordinary shares issued for 56 days in the year. 5,000 ordinary shares issued for 92 days in the year.	
e	Profit: 6,000 Income tax: 1,800	35,000 ordinary shares issued for 192 days in the year. 17,500 ordinary shares issued for 264 days in the year.	

Question 30

Question	Earnings Per Share		Increasing or decreasing?
	Year 1	Year 2	
a	\$0.09 cents per share	\$0.07 cents per share	
	2018	2017	Increasing or decreasing?
b	\$0.15 cents per share	\$0.13 cents per share	
	2024	2023	Increasing or decreasing?
c	\$0.18 cents per share	\$0.12 cents per share	

d. Describe two interpretations of this ratio increasing.

e. Describe two interpretations of this ratio decreasing.

Price / Earnings

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Market	Review of the ASX performance of public companies.	Price / Earnings	Market price per ordinary share compared to earnings per share.	Market price per ordinary share	<ul style="list-style-type: none"> Higher valuation of shares by current investors. Higher valuation of shares by market. 	<ul style="list-style-type: none"> Lower valuation of shares by current investors. Lower valuation of shares by market.
				Earnings per share		

Example

The following financial information has been provided for Pear Computers for the year ended 30 June 2038.

Dividend paid – ordinary shares	\$72,000
Earnings per share	\$0.08
Number of ordinary shares issued	900,000
Share price - ordinary	\$1.40

Additional information:

- The price / earnings ratio for the year ended 30 June 2037 was 14.35 times.

Required task:

Evaluate the price/earnings ratio for Pear Computers.

Solution

Step 1 – Calculate the price / earnings.

$$\text{Price / Earnings} = \frac{\text{Market price per ordinary share}}{\text{Earnings per share}}$$

$$\begin{aligned} \text{Price / earnings} &= 1.40 / 0.08 \\ &= 17.50 \text{ times} \end{aligned}$$

Note: If the earnings per share value is not provided in the question this is calculated using the earnings per share ratio formula which is in the specification booklet.

Note: In this example there is no information provided to calculate weighted average number of ordinary shares issued. If a question required calculation of earnings per share, this would be calculated using the number of ordinary shares (not the weighted average number of ordinary shares).

Step 2 – Evaluate the price / earnings.

The price / earnings ratio indicates the market price per ordinary share compared to earnings per share.

The price / earnings ratio has increased from 14.35 times in 2037 to 17.50 times in 2038 which is positive. This increase can be interpreted as:

- Higher valuation of shares by current investors.
- Higher valuation of shares by market.

Practice Questions

Questions 31-32: Price / Earnings Ratio.

$$\text{Price / Earnings} = \frac{\text{Market price per ordinary share}}{\text{Earnings per share}}$$

Question 31

Question	Market price per ordinary share	Earnings per share	Price / Earnings
a	\$3.20	\$0.33	$\frac{3.20}{0.33}$ = 9.70 times
b	\$6.70	\$0.72	
c	\$8.20	\$1.30	
d	\$1.32	\$0.15	
e	\$3.47	\$0.25	

Question 32

Question	Price / Earnings		Increasing or decreasing?
	Year 1	Year 2	
a	7.12 times	3.51 times	
	2022	2023	Increasing or decreasing?
b	8.75 times	11.35 times	
	2023	2022	Increasing or decreasing?
c	5.48 times	6.32 times	

d. Describe two interpretations of this ratio increasing.

e. Describe two interpretations of this ratio decreasing.

Dividend Yield

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Market	Review of the ASX performance of public companies.	Dividend Yield	Dividends paid compared to share price.	$\frac{\text{Annual dividend per ordinary share}}{\text{Market price per ordinary share}}$	<ul style="list-style-type: none"> Perception by the market that the company is a valuable investment. 	<ul style="list-style-type: none"> Perception by the market that the company is a less valuable investment.

Example

The following financial information has been provided for Pear Computers for the year ended 30 June 2038.

Dividend paid – ordinary shares	\$72,000
Earnings per share	\$0.08
Number of ordinary shares issued	900,000
Share price - ordinary	\$1.40

Additional information:

- The dividend yield ratio for the year ended 30 June 2037 was 3.23 times.

Required task:

Evaluate the price/earnings ratio for Pear Computers.

Solution

Step 1 – Calculate the dividend yield.

$$\text{Dividend Yield} = \frac{\text{Annual dividend per ordinary share}}{\text{Market price per ordinary share}} \times 100$$

If the earnings per share was not provided, this could be calculated as:

$$\begin{aligned} \text{Annual dividend per ordinary share} &= \text{Total dividend paid} / \text{number of ordinary shares} \\ &= 72,000 / 900,000 \\ &= 0.08 \end{aligned}$$

Note: This formula is not provided in the specification booklet.

$$\begin{aligned} \text{Dividend yield} &= (0.08 / 1.40) \times 100 \\ &= 5.71 \text{ times} \end{aligned}$$

Therefore, the dividend yield is 5.71 times.

Step 2 – Evaluate the dividend yield.

The dividend yield ratio indicates the dividends paid compared to share price.

The dividend yield has increased from 3.23 times in 2037 to 5.71 times in 2038. This positive increase indicates:

- A perception by the market that the company is a valuable investment.

Practice Questions

Questions 33-34: Dividend Yield Ratio.

Questions 35-36: All Market Ratios.

$$\text{Dividend Yield} = \frac{\text{Annual dividend per ordinary share}}{\text{Market price per ordinary share}} \times 100$$

Question 33

Question	Annual dividend per ordinary share	Market price per ordinary share	Dividend Yield
a	\$0.23	\$2.70	$\frac{0.23}{2.70}$ = 8.52 times
b	\$1.40	\$12.20	
c	\$0.68	\$8.23	
d	\$3.54	\$18.90	
e	\$0.08	\$1.11	

Question 34

Question	Dividend Yield		Increasing or decreasing?
	Year 1	Year 2	
a	1.2%	1.4%	
	2033	2034	Increasing or decreasing?
b	10.2%	15.6%	
	2026	2025	Increasing or decreasing?
c	13.2%	18.3%	

d. Describe three interpretations of this ratio increasing.

e. Describe three interpretations of this ratio decreasing.

Question 36

The following financial information has been provided for Speak Up Social Change for the year ended 30 June 2027.

Financial information for Speak Up Social Change as at 30 June 2027	
Dividend paid – ordinary shares	160,000
Number of ordinary shares issued	1,800,000
Share price - ordinary	1.40
Net profit after tax	1,550,000
Weighted average number of ordinary shares	1,720,000

Required tasks:

a. Calculate the dividend yield ratio.

Workings

c. Calculate the earnings per share ratio.

Workings

b. Calculate the price / earnings ratio.

Workings

Ratios – Other theory

Ratio comparisons

Ratios may be calculated and then compared with

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

Limitations in assessing performance from ratios and traditional financial accounting

List	Describe
Historic focus not future focus	Ratios reflect historic performance and do not predict future performance.
Need for comparison	Ratios need to be compared with other information to be most useful. See Ratio comparisons section above.
Timeliness	GPFs are produced after a financial period and company position will have changed by the time GPFs are able to be analysed.
External influences on market ratios	Market ratios are heavily influenced by external factors such as speculation, political events, news stories etc. These external influences are not always related to company's performance.
Historical figures ignore inflation	Data used to calculate ratios uses historical figures which are not adjusted for inflation (present value).
Accounting methods between entities	Different businesses use varied methods to apply accounting standards. Especially for qualitative information. This makes comparability between entities difficult.
Lack of disclosure	Full disclosure is impossible. Confidentiality required to retain confidential company trade secrets which generate competitive advantage.
Data manipulation	Data could be manipulated to make data appear more desirable. This will impact ratio calculation and comparisons.
Only a guide, not a reason	Ratios may highlight positive and or negative areas but will not identify causes. Especially qualitative causes e.g., non-financial KPIs such as culture, high staff turnover etc. do not appear on GPFs or ratios.

Note: Know any 3.

How it is possible to have high profitability but poor liquidity

- Possible because income can be earned with customers paying on credit rather than cash.
- Internal control over accounts receivable required to collect cash from debtors quickly / efficiently.
- Poor internal control negatively impacts cash flow.

Note: Provide definitions of profitability and liquidity before describing above dot points.



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