

Essential Insight – Practical Guide Unit 2

Accounting and Finance Year 11 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 1	Unit 2
1. Small Business Structures	11. Inventory Costing Methods
2. Bankruptcy and Sources of Finance	12. Professional Associations and Code of Conduct
3. Accounting Introduction	13. Depreciation and Sale of Asset
4. Accounting Principles	14. Balance Day Adjustments
5. Goods and Services Tax	15. Classified Financial Statements with Balance Day Adjustments
6. AASB Conceptual Framework and Financial Statements	16. Ratios
7. General Journal and General Ledger Introduction	17. Electronic Processing
8. Inventory Systems – Perpetual and Periodic Methods	18. Accounting Software (Resources for this chapter are on the Resource Hub)
9. Internal Control	
10. Corporate Social Responsibility	

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.

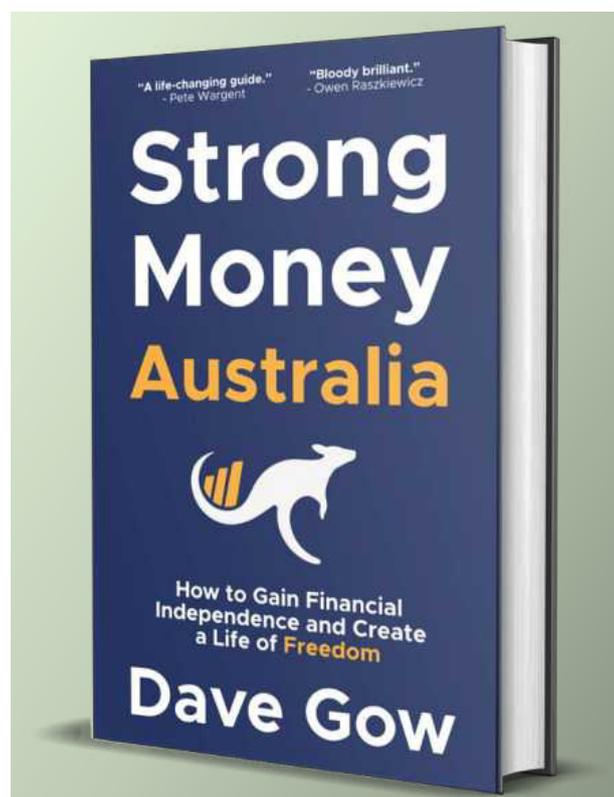
As future professionals in finance, you may be entrusted to advise others on similar matters. Acquiring expertise in the growing field of financial independence equips you to provide valuable guidance to clients, colleagues, or businesses.

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.



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Syllabus – Unit 2

Syllabus – Unit 2	
Inventory Costing Methods	<p>Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • concept of inventory costing methods <ul style="list-style-type: none"> ▪ weighted average ▪ First-in First-out
Professional Associations and Code of Conduct	<p>The role and influence of governments and other bodies</p> <ul style="list-style-type: none"> • the role of the professional accounting and financial associations, including: <ul style="list-style-type: none"> ▪ CPA Australia ▪ Chartered Accountants Australia and New Zealand ▪ The Institute of Public Accountants ▪ Financial Planning Association of Australia Limited <p>The influence of social, environmental and ethical factors</p> <ul style="list-style-type: none"> • the nature and purpose of the professional codes of conduct for members of professional accounting service providers associations
Depreciation and Sale of Asset	<p>Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • nature of depreciable non-current assets • nature of depreciation expense • determining the cost of a depreciable non-current asset • identification of the more appropriate method of depreciation to apply <ul style="list-style-type: none"> ▪ straight line ▪ reducing/diminishing balance • identification of over or under depreciation on sale of non-current asset <p>Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • manual preparation of general journal and general ledger entries for recording of depreciation and disposal of a single depreciable asset, including cost of a depreciable non-current asset, depreciation expense, disposal of depreciable asset using the sale of asset method • manual preparation of closing general journal entries
Balance Day Adjustments	<p>Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • 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 <p>Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • manual preparation of general journal and ledger entries for balance day adjustments (asset and liability method only) to prepare financial reports (GST not included) • manual preparation of closing general journal entries
Classified Financial Statements with Balance Day Adjustments	<p>Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • manual preparation of trial balance • manual preparation of classified financial statements for a sole trader, including balance day adjustments <ul style="list-style-type: none"> ▪ income statements ▪ statement of financial position for a trading/merchandising/service business
Ratios	<p>Recording, processing and communicating financial information / Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • preparation and interpretation of the following ratios to evaluate the profitability and stability of a business: <ul style="list-style-type: none"> ▪ profitability ratios <ul style="list-style-type: none"> ○ profit ○ gross profit ○ expense ○ rate of return on assets ▪ liquidity ratios: <ul style="list-style-type: none"> ○ working capital formula ○ quick asset formula ▪ leverage ratio: <ul style="list-style-type: none"> ○ debt to equity formula
Electronic Processing	<p>Financial institutions</p> <ul style="list-style-type: none"> • nature, benefits and risks to small business of the following types of electronic processing: <ul style="list-style-type: none"> ▪ EFTPOS ▪ bill payments – electronic payment system ▪ credit cards ▪ online banking ▪ direct debits
Accounting Software	<p>Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • using an established chart of accounts and the perpetual inventory system, apply double entry principles using accounting software such as Mind Your Own Business (MYOB) or QuickBooks® to electronically record financial data and produce financial reports <p><i>Note: Step-by-step accounting software activities are provided on the resource hub.</i></p>

School Curriculum and Standards Authority, (2020). Accounting and Finance ATAR course Year 11 syllabus. The School Curriculum and Standards Authority does not endorse this publication or product.

11. Inventory Costing Methods



Activate Prior Knowledge

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

<p>If a business purchases inventory at different prices throughout the year, how would it be possible to calculate the cost of a sales?</p>	
<p>Which would be easier to count: individual product costs for a manufactured product, or the amount of wheat produced in a field over harvest season?</p>	
<p>Do you think all businesses use the same inventory costing methods? Why?</p>	

Inventory Costing Methods – Syllabus

Syllabus – Unit 2	
Inventory Costing Methods	Financial systems and fundamental principles <ul style="list-style-type: none"> • concept of inventory costing methods <ul style="list-style-type: none"> ▪ weighted average ▪ First-in First-out

Inventory Costing Methods – Introduction

Businesses record the prices paid to purchase inventory and the sale of this inventory at a later date. Inventory is purchased at different prices over time and therefore, the calculation of cost of sales can be calculated using one of many methods. Each inventory costing method has its different advantages and disadvantages. The inventory costing methods covered in this course are the 'First-In-First-Out Method' and the 'Weighted Average Method.'

First-In First-Out Method – Summary Table

First-In First-Out Method (FIFO)	
Nature	The first inventory purchased is the first inventory sold. Inventory remaining after sales is recorded as the value of latest inventory purchased. Often used when inventory is easily counted and may have expiration dates e.g., fresh produce, manufactured products.
Calculation	$\text{Cost of sales for a given number of units} = \text{Adding together the cost of units of inventory purchased first}$ Inventory closing balance is recorded as the value of remaining latest inventory purchased.
Advantages	<ul style="list-style-type: none"> • Closing inventory value reflects current market value. • Higher profits during times when prices increase.
Disadvantages	<ul style="list-style-type: none"> • Not accurate if inventory cost has fluctuating price patterns. • During times of inflation, this results in higher profits and thus higher taxes. • During times when prices fall, cost of production may be higher.

Note: General journal and ledger entries for inventory costing methods are not included in the syllabus.

Example

A business imports and sells leather belts.

- On 10 June 2032, the business purchases 50 belts for \$10 each.
- On 15 June 2032, the business purchases 40 belts for \$15 each.
- On 28 June 2032, the business sells 60 belts.

Required task:

Calculate the cost of inventory sold for the month ended 30 June 2032.

Calculate the value of the remaining inventory as at 30 June 2032.

Solution

Step 1 – Calculation of cost of sales.

The belts purchased first are recognised as the inventory that was sold first, followed by the next inventory purchase.

$\text{Cost of sales} = \left(\begin{array}{l} \text{Number of} \\ \text{units from first} \\ \text{purchase} \end{array} \times \begin{array}{l} \text{Their} \\ \text{value} \end{array} \right) + \left(\begin{array}{l} \text{Remaining units} \\ \text{from the second} \\ \text{purchase} \end{array} \times \begin{array}{l} \text{Their} \\ \text{value} \end{array} \right)$

$$\text{Cost of sales} = (50 \times \$10) + (10 \times \$15) = \$650$$

Therefore, the cost of sales is \$650 for the month ended 30 June 2032.

Step 2 – Calculation of closing inventory balance.

The closing inventory balance can be calculated by using the below formula.

$$\text{Closing Inventory Balance} = \text{Remaining Units} \times \text{Their Value}$$

$$\begin{aligned}\text{Closing Inventory Balance} &= [(50 - 50) \times \$10] + [(40 - 10) \times \$15] \\ &= 0 + (30 \times 15) \\ &= \$450\end{aligned}$$

An alternative formula option that can be used is:

$$\text{Closing Inventory Balance} = \text{Opening Inventory Balance} + \text{Net Purchases} - \text{Cost of Sales}$$

$$\begin{aligned}\text{Closing Inventory Balance} &= 0 + [(50 \times 10) + (40 \times 15)] - 650 \\ &= \$450\end{aligned}$$

Therefore, the closing inventory balance is \$450 as at 30 June 2032.

Practice Questions

Questions 1-4: First-In First-Out Method.

Tip	<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.

Question 1

Swan Valley Fresh supplied the following information for the month ended 28 February 2038.

- On 1 February, 50 avocados purchased for \$0.50 each.
- On 12 February, 20 avocados were purchased for \$0.70 each.
- On 13 February, 65 avocados were sold.

Required tasks:

- Calculate the cost of inventory sold for the month ended 28 February 2038.
- Calculate the value of the remaining inventory as at 28 February 2038.

Workings

Question 2

The following information has been provided by Petrol Wholesalers for the month ended 31 August 2040.

- On 5 August, 200 barrels of petrol was purchased for \$120 each.
- On 14 August, 100 barrels of petrol was sold.
- On 18 August 150 barrels of petrol was purchased for \$110 each.
- On 23 August 180 barrels of petrol was sold.

Required tasks:

- a. Calculate the cost of inventory sold for the month ended 31 August 2040.
- b. Calculate the value of the remaining inventory as at 31 August 2040.

Workings

Question 3

The following information has been supplied by Blizzard Fans for the month ended 30 April 2025.

- On 2 April, 20 fans were purchased for \$80 each.
- On 12 April, 50 fans were purchased for \$70 each.
- On 13 April, 50 fans were sold.
- On 18 April, 30 fans were purchased for \$74 each.
- On 25 April, 40 fans were sold.

Required tasks:

- a. Calculate the cost of inventory sold for the month ended 30 April 2025.
- b. Calculate the value of the remaining inventory as at 30 April 2025.

Workings

Question 4

Enhance Long Life Milk provided the following information for the month ended 31 October 2048.

- On 1 October, 100 litres of milk were purchased for \$1.10 per litre.
- On 10 October, 200 litres of milk were purchased for \$1.00 per litre.
- On 15 October, 130 litres of milk were sold.
- On 20 October, 120 litres of milk were purchased for \$1.05 per litre.
- On 25 October, 50 litres of milk were sold.

Required tasks:

- a. Calculate the cost of inventory sold for the month ended 31 October 2048.
- b. Calculate the value of the remaining inventory as at 31 October 2048.

Workings

Weighted Average Method – Summary Table

Weighted Average Method	
Nature	Inventory cost is the average cost of goods available for sale during a given period. Inventory cost calculated changes based on each inventory purchase in a period. Often used when inventory items are so similar or closely linked that it is difficult to assign a cost to a specific unit. E.g., fuel companies, large scale agriculture.
Calculation	$\text{Weighted average cost per unit} = \frac{\text{Total cost of goods available for sale}}{\text{Total units in inventory}}$ <p>The process for calculating closing inventory value per unit and cost of sales per unit is the same.</p>
Advantages	<ul style="list-style-type: none"> • Simple to calculate. • Reduces impact of fluctuating prices on cost of sales and closing inventory. • Can save time in setting prices if prices are based on cost of goods sold.
Disadvantages	<ul style="list-style-type: none"> • Quotes may not reflect current market prices if prices fluctuate widely. • If costs have increased recently, goods may be sold at a loss. • The cost allocated to a specific sale is not the actual cost of that sale.

Note: General journal and ledger entries for inventory costing methods are not included in the syllabus.

Example

A business purchases and sells chairs and had recorded the following information during March.

- On 9 March 2035, the business purchased 30 chairs for \$46.
- On 16 March, the business purchased 50 chairs for \$42.
- During March 2035, the business sold 70 chairs.

Required task:

Calculate the cost of inventory sold for the month ended 31 March 2035.

Calculate the value of the remaining inventory as at 31 March 2035.

Solution

Step 1 – Calculation of cost of sales.

The weighted average cost per unit must first be calculated. This is then multiplied by the number of sales to calculate the cost of sales.

$$\text{Weighted Average Cost per unit} = \frac{\text{Total cost of each purchase}}{\text{Units of inventory}}$$

Total cost of each purchase = Cost of each unit of inventory x Units of inventory

$$\text{Cost of sales} = \text{Weighted Average Cost per unit} \times \text{Number of sales}$$

$$\begin{aligned} \text{Weighted average cost per unit} &= [(30 \times 46) + (50 \times 42)] / (30+50) \\ &= (1,380 + 2,100) / 80 \\ &= \$43.50 \end{aligned}$$

$$\begin{aligned} \text{Cost of sales} &= 43.50 \times 70 \\ &= \$3,045 \end{aligned}$$

Therefore, the cost of sales was \$3,045 for the month ended 31 March 2035.

Step 2 – Calculation of closing inventory balance.

The closing inventory balance can be calculated by using the below formula.

$$\begin{array}{r} \text{Closing} \\ \text{Inventory} \\ \text{Balance} \end{array} = \begin{array}{r} \text{Weighted Average} \\ \text{Cost per unit} \end{array} \times \begin{array}{r} \text{Remaining} \\ \text{Units} \end{array}$$

$$\begin{aligned} \text{Closing inventory balance} &= \$43.50 \times (30 + 50 - 70) \\ &= \$435 \end{aligned}$$

An alternative formula option that can be used is:

$$\begin{array}{r} \text{Closing Inventory} \\ \text{Balance} \end{array} = \begin{array}{r} \text{Opening Inventory} \\ \text{Balance} \end{array} + \begin{array}{r} \text{Net} \\ \text{Purchases} \end{array} - \begin{array}{r} \text{Cost of} \\ \text{Sales} \end{array}$$

$$\begin{aligned} \text{Closing inventory balance} &= 0 + [(30 \times 46) + (50 \times 42)] - 3,045 \\ &= (1,380 + 2,100) - 3,045 \\ &= \$435 \end{aligned}$$

Therefore, the closing inventory balance is \$435 as at 31 March 2035.

Practice Questions

Questions 5-8: Weighted Average Method.

Question 9-13: Inventory Costing Methods theory review.

Question 5

The following information was provided by Frog Ponds for the month ended 30 November 2041.

- On 4 November, 15 ponds were purchased for \$80 each.
- On 9 November, 20 ponds were purchased for \$70 each.
- On 14 November 10 ponds were sold.

Required tasks:

- a. Calculate the cost of inventory sold for the month ended 30 November 2041.
- b. Calculate the value of the remaining inventory as at 30 November 2041.

Workings

Question 6

The following information was provided by Big Bob's Bears for the month ended 31 January 2030.

- On 10 January, were purchased 10 teddy bears for \$7 each.
- On 12 January, 8 teddy bears were sold.
- On 13 January, 20 teddy bears were purchased for \$8 each.
- On 18 January, 15 teddy bears were sold.

Required tasks:

- a. Calculate the cost of inventory sold for the month ended 31 January 2030.
- b. Calculate the value of the remaining inventory as at 31 January 2030.

Workings

Question 7

Desert Survivor has supplied the following information for the year ended 30 June 2035.

- On 1 July 2034, the opening inventory balance of water bottles was 2,000 bottles with a weighted average cost per unit of \$10.
- By 30 September 2034, 1,500 water bottles had been sold.
- On 10 October 2034, 3,000 water bottles were purchased for \$8 each.
- By 31 December, 2,200 bottles had been sold since September.
- On 25 January 1,400 bottles were purchased for \$6 each.

Required tasks:

- a. Calculate the cost of inventory sold for the month ended 30 June 2035.

Tip: The opening inventory balance weighted average cost per unit can be treated in the same manner as a purchase. I.e., multiple the number of units by the weighted average cost and then continue adding the other purchases multiplied by the purchase price.

- b. Calculate the value of the remaining inventory as at 30 June 2035.

Workings

Question 8

Snooze Max has supplied the following information for the year ended 30 June 2029.

- On 15 July 2028, the business purchased 210 beds for \$120 each.
- On 31 December 2028, 180 beds had been sold in the past 6 months.
- On 20 October 2028, the business purchased 80 beds for \$150 each.
- On 2 February 2029, the business purchased 200 beds for \$100 each.
- On 30 June 2029, 200 beds had been sold in the past 6 months.

Required tasks:

- a. Calculate the cost of inventory sold for the month ended 30 June 2029.
- b. Calculate the value of the remaining inventory as at 30 June 2029.

Workings

Practice Questions

Question 9-13: Inventory Costing 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.

Question 9

The inventory costing method best suited for lettuce would be:

- a. Weighted average.
- b. Last-in first-out.
- c. First-in first-out.
- d. First-in last-out.

Question 10

Identify an advantage of the first in first out method of inventory costing.

- a. Can save time in setting prices if prices are based on cost of goods sold.
- b. Closing inventory value reflects current market value.
- c. Simple to calculate.
- d. Higher profits during times when prices decrease.

Question 11

Identify a disadvantage of the weight average inventory costing method.

- a. During times of inflation results in higher profits recorded and therefore higher taxes.
- b. Not accurate if inventory cost has fluctuating price patterns.
- c. If costs have increased recently, goods may be sold at a high price.
- d. The cost allocated to a specific sale is not the actual cost of that sale.



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13. Depreciation and Sale of Asset



Activate Prior Knowledge

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

<p>When you buy your first car how much do you think it is likely to cost?</p>	
<p>If you were to sell this car ten years later, how much do you think it will be worth? Why?</p>	
<p>How can we account for the change in value of the car over its useful life? Why?</p>	

Depreciation and Sale of Asset – Syllabus

Syllabus – Unit 2	
Depreciation and Sale of Asset	<p>Financial systems and fundamental principles</p> <ul style="list-style-type: none"> • nature of depreciable non-current assets • nature of depreciation expense • determining the cost of a depreciable non-current asset • identification of the more appropriate method of depreciation to apply <ul style="list-style-type: none"> ▪ straight line ▪ reducing/diminishing balance • identification of over or under depreciation on sale of non-current asset <p>Recording, processing and communicating financial information</p> <ul style="list-style-type: none"> • manual preparation of general journal and general ledger entries for recording of depreciation and disposal of a single depreciable asset, including cost of a depreciable non-current asset, depreciation expense, disposal of depreciable asset using the sale of asset method <ul style="list-style-type: none"> ▪ manual preparation of closing general journal entries

Depreciation and Sale of Asset – Introduction

All non-current assets lose value over time for a variety of reasons including wear-and-tear and obsolescence. Eventually these non-current assets must be sold or written off. Depreciation is the process of allocating the cost of an asset over its useful life. There are several depreciation methods, but the two methods detailed in this course are the straight line method and the reducing balance method. Each type of depreciation will be more or less appropriate for different types of non-current assets.

Depreciation – Key Definitions

	Nature
Legislation	AASB 116 Property, Plant and Equipment.
Depreciable Non-Current Assets	<p>Are tangible items that are:</p> <ul style="list-style-type: none"> • Held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. • Expected to be used during more than one period. <p>A tangible asset:</p> <ul style="list-style-type: none"> • Is a physical object. • Can be touched.
Depreciable amount	The cost of an asset less residual value.
Depreciation Expense	The systematic allocation of the depreciable amount of an asset over its useful life.
Residual value / Market value	The estimated market value when an asset is sold at the end of its useful life. This is estimated at the start of an asset's life. It is difficult to know the exact value until an asset is sold.
Carrying value / Carrying amount	<p>The historical cost less accumulated depreciation at any given time.</p> <ul style="list-style-type: none"> • Carrying Value = Historical Cost – Accumulated Depreciation

Historical Cost – Summary Table

	Historical Cost
Nature	The determined original cost of a depreciable non-current asset in accounting records.
Formulated by	<ul style="list-style-type: none"> • Purchase price: <ul style="list-style-type: none"> ◦ Selling price, Import taxes, legal fees. • Costs that increase the assets useful life: <ul style="list-style-type: none"> ◦ Modifications, refurbishment, remodelling. • Costs that increase ability of asset to generate revenue: <ul style="list-style-type: none"> ◦ Upgrades, advertising on the asset such as logos. • Costs that relocate the asset for use or prepare the asset for use: <ul style="list-style-type: none"> ◦ Transport, transport insurance, assembly, installation.
Not formulated by	<ul style="list-style-type: none"> • GST payments. • Yearly registration. • Yearly insurance. • Ongoing repairs and maintenance.

Causes of Depreciation

Cause of depreciation	Description	Example
Wear and Tear	Usage of an asset over time gradually reduces the efficiency of the asset.	A cake making machine has a useful life of 12 years. Over time parts need to be replaced. Eventually the asset can no longer be repaired and must be disposed. As a result, the value decreases over time.
Technical Obsolescence	New technology results in an asset no longer being wanted or needed and losing value.	Smart phones stop receiving updates after approximately 4 years. As a result, these older models lose value.
Commercial Obsolescence	Demand decreases for goods or services that an asset produces, resulting in the asset losing value.	Demand for older computer parts decreases over time. As a result, the machinery used to make these computer parts loses value.



Mont Blanc, Chamonix.

Depreciation Methods - Introduction

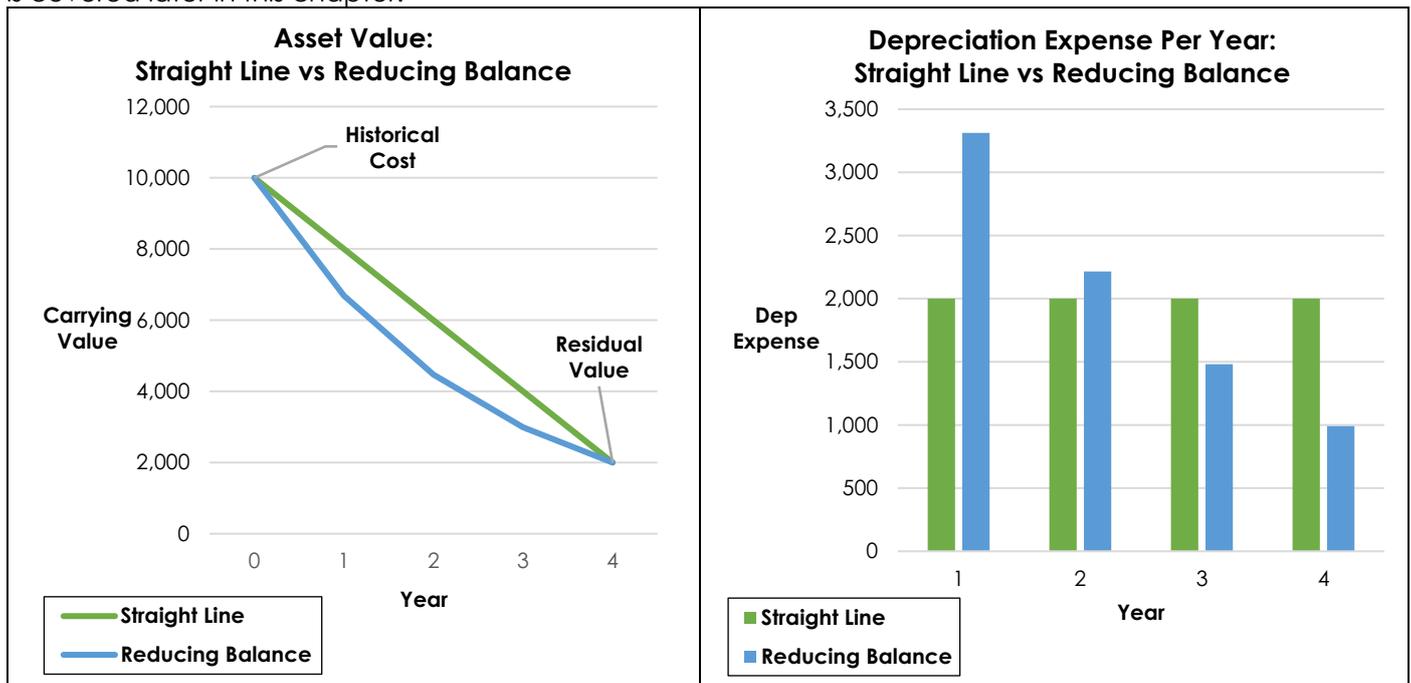
At the end of each period, the depreciation of an asset that has occurred is calculated and recorded as an expense in the general ledger, general journal and appears in financial statements. The methods of estimating depreciation expense covered in this course are straight line and reducing balance method.

Straight Line Depreciation Method

Straight Line Method	
Calculation	$\text{Depreciation expense} = \frac{\text{Original Cost} - \text{Residual Value}}{\text{Useful Life}}$ <ul style="list-style-type: none"> • Original Cost: Historical cost. • Residual value: The estimated market value when an asset is sold. • Useful life: The time period an asset is estimated to be able to be used by a business.
Depreciation expense	Equal each year.
Use method when	<ul style="list-style-type: none"> • Income generated by asset evenly over useful life. • Cause of depreciation is even over useful life.
Examples	<ul style="list-style-type: none"> • Furniture. • Buildings. • Fixtures and fittings.

Depreciation Methods – Visualization of Asset Value and Depreciation Expense each year

The below graphs demonstrate asset value and depreciation expense for the straight line method and reducing balance method. Only the straight line method has been covered so far. Reducing Balance method is covered later in this chapter.



Note: Carrying Value = Historical Cost – Accumulated Depreciation.

Example

The following information has been provided by Planet Recycle.

On 11 March 2031, the business purchased machinery for \$9,000 + \$9,000 GST. The machinery cost \$300 + \$30 GST to transport to the business and \$200 + \$20 GST to install. The machinery was also modified to suit the businesses needs costing \$1,000 + \$100 GST. The insurance cost for the machinery will be \$500 + \$50 GST and annual maintenance costs will be \$250 + \$25 GST. The asset was ready for use on 1 April 2031.

The machinery has a useful life of 4 years and a residual value of \$2,500.

Required task:

- Calculate the depreciation expense using the straight line method for the years ended 30 June 2031, 30 June 2032 and 30 June 2033.
- Calculate the depreciation rate per year.
- Prepare the general journal and general ledger to record the depreciation expense and the transfer of the depreciation expense to profit and loss account for the years ended 30 June 2031 and 30 June 2032.
- Prepare the balance sheet to demonstrate the machinery and accumulated depreciation for the years ended 30 June 2031 and 30 June 2032.

Solution

Step 1 – Calculation of historical cost.

Historical cost is made up of the purchase price of an asset and one-off costs to setup the asset. Historical cost does not include GST payments or yearly ongoing costs.

	Historical Cost
Nature	The determined original cost of a depreciable non-current asset in accounting records.
Formulated by	<ul style="list-style-type: none">• Purchase price:<ul style="list-style-type: none">◦ Selling price, Import taxes, legal fees.• Costs that increase the assets useful life:<ul style="list-style-type: none">◦ Modifications, refurbishment, remodelling.• Costs that increase ability of asset to generate revenue:<ul style="list-style-type: none">◦ Advertising on the asset such as logos.• Costs that relocate the asset for use or prepare the asset for use:<ul style="list-style-type: none">◦ Transport, transport insurance, assembly, installation.
Not formulated by	<ul style="list-style-type: none">• GST payments.• Yearly registration.• Yearly Insurance.• Ongoing repairs and maintenance.

Historical cost = 9,000 (Purchase price) + 1,000 (Modification cost) + 300 (Transport cost) + 200 (Installation cost)
= \$10,500

Therefore, historical cost is \$10,500.

Step 2 – Calculation of annual depreciation expense.

$$\text{Annual Depreciation Expense} = \frac{\text{Historical cost} - \text{Residual Value}}{\text{Useful Life}}$$

$$\begin{aligned}\text{Annual depreciation expense} &= (10,500 - 2,500) / 4 \\ &= 8,000 / 4 \\ &= \$2,000\end{aligned}$$

Therefore, the annual depreciation expense is \$2,000.

For the years ended 30 June 2032 and 2033, the asset was owned for a full year. Therefore, for these two years \$2,000 is the depreciation expense recorded.

Note: Some questions may express the annual depreciation rate as a percentage of the historical cost. In this instance, the historical cost is multiplied by the annual depreciation percentage. The resulting annual depreciation expense calculated is the same for each full year.

For example, in this question if the depreciation rate was given in the question as 19.05%, the useful life and residual value would not need to be provided to calculate the annual depreciation expense. See workings below.

$$\text{Annual Depreciation Expense} = \text{Historical cost} \times \text{Annual Depreciation Rate}$$

$$\begin{aligned}\text{Annual Depreciation Expense} &= 10,500 \times 0.1905 \\ &= \$2000\end{aligned}$$

Therefore, the annual depreciation expense is \$2,000.

Step 3 – Calculation of depreciation rate.

The depreciation rate can be calculated using the below formula if the depreciation rate is not provided in the question.

$$\text{Depreciation Rate} = \frac{\text{Annual Depreciation Expense}}{\text{Historical Cost}}$$

$$\begin{aligned}\text{Depreciation rate} &= 2,000 / 10,500 \\ &= 19.05\%\end{aligned}$$

Therefore, this non-current asset depreciates at a rate of 19.05%. This means that the asset loses 19.05% of its value each year.

Step 4 – Calculation of part year depreciation expense.

For the year ended 30 June 2031, the asset was owned for a partial year, not a full year. Therefore, the depreciation expense must be calculated as a portion of a whole year.

$$\text{Partial Year Depreciation Expense} = \frac{\text{Historical cost} - \text{Residual Value}}{\text{Useful Life}} \times \frac{\text{Months NCA was owned}}{12}$$

The asset was ready for use on 1 April 2031. The below diagram represents the months of the year the asset was ready for use until balance day.



Therefore, the NCA was owned for 3 months during the initial partial year of ownership until balance day.

$$\begin{aligned} \text{Partial year depreciation expense} &= [(10,500 - 2,500) / 4] \times (3/12) \\ &= 2000 \times 3/12 \\ &= \$500 \end{aligned}$$

Therefore, the depreciation expense recorded for the year ended 30 June 2033 is \$500.

Note: Partial years of depreciation are likely to occur during the year an asset was purchased and the year an asset was sold, with full years of depreciation in between.

Step 5 – Year 1 Depreciation Expense and Accumulated Depreciation.

The Year 1 depreciation expense is the initial part year of depreciation calculated in the previous step. The depreciation expense entry is accompanied by an accumulated depreciation entry.

- Debit Depreciation of Machinery \$500 to increase this expense account.
- Credit Accumulated Depreciation of Machinery \$500 to increase this contra asset account.

The accumulated depreciation account is balanced. The balance will appear in the balance sheet.

Date	Details	Debit	Credit
30 Jun 2031	Depreciation of Machinery	500	
	Accumulated Depreciation of Machinery		500
	Depreciation expense		

Depreciation of Machinery					
Date	Description	\$	Date	Description	\$
30 Jun 2031	Accumulated Depreciation of Machinery	500			

Accumulated Depreciation of Machinery					
Date	Description	\$	Date	Description	\$
30 Jun 2031	Balance c/d	500	30 Jun 2031	Depreciation of Machinery	500
		500			500
			1 Jul 2031	Balance b/d	500

Step 6 – Year 1 Depreciation Expense to Profit and Loss.

The depreciation expense account is closed each period to the profit and loss account. Depreciation will appear as an expense in the income statement.

- Debit Profit and Loss \$500 to this working account.
- Credit Depreciation of Machinery \$500 to decrease this expense account.

Date	Details	Debit	Credit
30 Jun 2031	Profit and Loss Depreciation of Machinery Transfer of expense	500	500

Profit and Loss					
Date	Description	\$	Date	Description	\$
30 Jun 2031	Depreciation of Machinery	500			

Depreciation of Machinery					
Date	Description	\$	Date	Description	\$
30 Jun 2031	Accumulated Depreciation of Machinery	500	30 Jun 2031	Profit and Loss	500

Step 7 – Year 1 Balance Sheet with Accumulated Depreciation.

The accumulated depreciation appears on the balance sheet as a separate entry that reduces the value of the asset. The value of \$10,000 is also known as the carrying value of the asset.

Carrying value = Historical Cost – Accumulated Depreciation.

Planet Recycle Balance Sheet (extract) as at 30 June 2031		
Non-Current Assets		
Machinery	10,500	
Less Accumulated Depreciation	(500)	10,000

Step 8 – Year 2 Depreciation Expense and Accumulated Depreciation.

The second year is a full year of ownership and therefore, the full year's depreciation expense applies.

- Debit Depreciation of Machinery \$2,000 to increase this expense account.
- Credit Accumulated Depreciation of Machinery \$2,000 to increase this contra asset account.

The accumulated depreciation account is balanced. The balance will appear in the balance sheet.

Date	Details	Debit	Credit
30 Jun 2032	Depreciation of Machinery Accumulated Depreciation of Machinery Depreciation expense	2,000	2,000

Depreciation of Machinery					
Date	Description	\$	Date	Description	\$
30 Jun 2032	Accumulated Depreciation of Machinery	2,000			

Accumulated Depreciation of Machinery					
Date	Description	\$	Date	Description	\$
30 Jun 2031		500	30 Jun 2031	Depreciation of Machinery	500
		500			500
30 Jun 2032	Balance c/d	2,500	1 Jul 2031	Balance b/d	500
			30 Jun 2032	Depreciation of Machinery	2,000
		2,500			2,500
			1 Jul 2032	Balance b/d	2,500

Step 9 – Year 2 Depreciation Expense to Profit and Loss.

The depreciation expense account is closed off to the profit and loss account.

- Debit Profit and Loss \$2,000 to this working account.
- Credit Depreciation of Machinery \$2,000 to decrease this expense account.

Date	Details	Debit	Credit
30 Jun 2032	Profit and Loss Depreciation of Machinery Transfer of expense	2,000	2,000

Profit and Loss					
Date	Description	\$	Date	Description	\$
30 Jun 2032	Depreciation of Machinery	2,000			

Depreciation of Machinery					
Date	Description	\$	Date	Description	\$
30 Jun 2032	Accumulated Depreciation of Machinery	2,000	30 Jun 2032	Profit and Loss	2,000

Step 10 – Year 2 Balance Sheet with Accumulated Depreciation.

The accumulated depreciation figure is found from the 'balance c/d' in the accumulated depreciation of machinery ledger.

Planet Recycle Balance Sheet (extract) as at 30 June 2032		
Non-Current Assets		
Machinery	10,500	
Less Accumulated Depreciation	(2,500)	8,000

The process demonstrated in steps 1-3 and then again in steps 4-6 repeats until the asset is sold or written off by being fully depreciated. Sale of a depreciable asset is covered later in this chapter.

Practice Questions

Questions 1-2: Depreciation Theory.

Questions 3-6: Historical Cost.

Questions 7-15: Straight Line Method of Depreciation.

Questions 16-18: Revision depreciation calculations for the straight line method of depreciation.

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

Describe three causes of depreciation.

Question 2

Describe the nature of the following terms:

- a. Depreciable Non-Current Assets.
- b. Depreciable amount.
- c. Depreciation Expense.
- d. Residual value / Market value.
- e. Carrying value / Carrying amount.

Question 3

- a. Describe the nature of historical cost.
- b. List items that do and do not formulate Historical cost.

Question 4

A business purchased an asset and recorded the following expenses.

- Cost of motor vehicle \$12,000 exclusive of GST.
- Cost of adding business logo to asset: \$500 + \$50 GST.
- Annual registration cost \$300 exclusive of GST.
- Cost of adding tow bar for business purposes: \$1,100 GST inclusive.

Required task:

Calculate the historical cost.

Question 5

A business purchased an asset and recorded the following expenses.

- Cost of office equipment \$11,000 inclusive of GST.
- Cost of setting up equipment to be ergonomic for staff \$550 inclusive of GST.
- Freight inwards cost \$400 GST exclusive.
- Office insurance cost \$700 + \$70 GST per year.

Required task:

Calculate the historical cost.

Question 6

A business purchased an asset and recorded the following expenses.

- Machinery was purchased for \$7,200 exclusive of GST.
- Maintenance costs per year \$770 inclusive of GST.
- Cost of installation \$400 GST exclusive.
- Cost of transporting equipment to warehouse \$150 + \$15 GST.
- Insurance per year \$330 inclusive of GST.

Required task:

Calculate the historical cost.

Question 9

For each of the below tasks, calculate the number of months to balance date and use this information to calculate the partial depreciation expense.

Note: The first task has been completed as an example.

Required tasks:

a. Calculate the depreciation expense from 1 March to 30 June. Annual depreciation expense is \$2,400.



4 months to balance date.

$$\text{Depreciation expense} = 2,400 \times (4/12) = \$800$$

Therefore, the depreciation expense from 1 March to 30 June is \$800.

b. Calculate the depreciation expense from 28 February to 30 June. Annual depreciation expense is \$3,000.



c. Calculate the depreciation expense from 1 October to 30 June. Annual depreciation expense is \$2,500.



d. Calculate the depreciation expense from 31 Jan to 30 June. Annual depreciation expense is \$4,800.



e. Calculate the depreciation expense from 1 August to 30 June. Annual depreciation expense is \$1,500.



f. Calculate the depreciation expense from 1 June to 30 June. Annual depreciation expense is \$6,300.



g. Calculate the depreciation expense from 30 Nov to 30 June. Annual depreciation expense is \$1,800.



Question 10

Blue Tech purchased office furniture on 14 June 2039. The office furniture was setup and ready to use on 1 July 2039. The office furniture had a historical cost of \$6,000, a residual value of \$1,000 and a useful life of 5 years.

Required tasks:

- a. Calculate the depreciation expense for the year ended 30 June 2040 and 30 June 2041.
- b. Prepare the general journal entries to record the depreciation expense and the transfer of the depreciation expense to profit and loss account for the years ended 30 June 2040 and 30 June 2041.

Date	Details	Debit	Credit
30 Jun 2040	<hr style="width: 80%; margin: 0 auto;"/> Accumulated Depreciation of Machinery Depreciation expense	1,000	1,000
30 Jun 2040	<hr style="width: 80%; margin: 0 auto;"/> Depreciation of Machinery Transfer of expense	1,000	1,000
30 Jun 2041	<hr style="width: 80%; margin: 0 auto;"/> Accumulated Depreciation of Machinery Depreciation expense	1,000	1,000
30 Jun 2041	<hr style="width: 80%; margin: 0 auto;"/> Depreciation of Machinery Transfer of expense	1,000	1,000

c. Prepare the general ledger entries to record the depreciation expense and the transfer of the depreciation expense to profit and loss account for the years ended 30 June 2040 and 30 June 2041.

Depreciation of Machinery					
Date	Description	\$	Date	Description	\$
30 Jun 2040	Accumulated Depreciation of Machinery	1,000	30 Jun 2040		
30 June 2041	Accumulated Depreciation of Machinery	1,000	30 June 2041		

Accumulated Depreciation of Machinery					
Date	Description	\$	Date	Description	\$
30 Jun 2040	Balance c/d	1,000	30 Jun 2040	Depreciation of Machinery	1,000
		1,000			1,000
30 June 2041			30 Jun 2040		
			30 June 2041		
		2,000			2,000
			30 June 2041	Balance b/d	

Profit and Loss					
Date	Description	\$	Date	Description	\$
30 Jun 2040					
30 June 2041	Depreciation of Machinery				

d. Prepare the balance sheet to demonstrate the office furniture and accumulated depreciation for the years ended 30 June 2040 and 30 June 2041.

Blue Tech Balance Sheet (extract) as at 30 June 2040		
Non-Current Assets		
Machinery		
Accumulated Depreciation of Machinery		

Blue Tech Balance Sheet (extract) as at 30 June 2040		
Non-Current Assets		
Machinery		
Accumulated Depreciation of Machinery		

c. Prepare the general ledger entries to record the depreciation expense and the transfer of the depreciation expense to profit and loss account for the years ended 30 June 2046 and 30 June 2047.

Depreciation of Motor Vehicle					
Date	Description	\$	Date	Description	\$

Accumulated Depreciation of Motor Vehicle					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

d. Prepare a balance sheet extract to demonstrate the office furniture and accumulated depreciation for the years ended 30 June 2046 and 30 June 2047.

Sky Bird Industries Balance Sheet (extract) as at 30 June 2046		
Non-Current Assets		

Sky Bird Industries Balance Sheet (extract) as at 30 June 2047		
Non-Current Assets		

Question 12

Foresight Optometry purchased fixtures and fittings on 19 December 2028. The following costs were associated with the fixtures and fittings:

- Purchase price \$6,600 GST exclusive.
- Insurance \$630 GST exclusive.
- Transport costs of \$110 inclusive of GST.
- Cost \$400 + \$40 GST to setup.

The fixtures and fittings were setup and ready for use on 31 December 2028. The useful life was 10 years and the residual value was \$1,000.

Required tasks:

a. Calculate the depreciation expense for the year ended 30 June 2029 and 30 June 2030.

Workings

Profit and Loss					
Date	Description	\$	Date	Description	\$

d. Prepare a balance sheet extract to demonstrate the office furniture and accumulated depreciation for the years ended 30 June 2029 and 30 June 2030.

Foresight Optometry Balance Sheet (extract) as at 30 June 2029		
Non-Current Assets		

Foresight Optometry Balance Sheet (extract) as at 30 June 2030		
Non-Current Assets		

Question 13

Medieval Fencing purchased a motor vehicle on 22 July 2051. The motor vehicle was ready for use on 1 August 2051. The residual value of the motor vehicle was \$6,000 and it had a useful life of 5 years. The following expenses were associated with the motor vehicle.

- Cost of adding business logo to motor vehicle \$700 + \$70 GST.
- Purchase of motor vehicle \$36,000 GST exclusive.
- The motor vehicle will need to maintenance every year costing \$300 + \$30 GST.
- The cost of the motor vehicle being delivered was \$300 + \$30 GST.
- Annual insurance cost \$440 GST inclusive.
- Modification costs \$2,000 + \$200 GST.

Required tasks:

a. Calculate the depreciation expense for the year ended 30 June 2052 and 30 June 2053.

Workings

b. Prepare the accumulated depreciation ledger account for the years ended 30 June 2024 and 30 June 2025.

Accumulated Depreciation of Motor Vehicle					
Date	Description	\$	Date	Description	\$

c. Prepare the non-current assets section of the balance sheet for 30 June 2025.

Balance Sheet (extract) as at 30 June 2025		
Non-Current Assets		
Motor Vehicle		
Accumulated Depreciation of Motor Vehicle		

Question 15

On 12 December 2051 a business purchased a computer chip machine for \$147,000 plus GST. Freight inwards from Taiwan cost \$600 GST exclusive. Modifications were made to the machine at a cost of \$12,000 GST exclusive. The machinery was insured with an annual premium of \$770 including GST. The machinery requires servicing every six months at a cost of \$800 plus GST per annum. The machinery had a useful life of five years and the machine could be broken down at the end of its useful life to sell for parts for a total of \$16,000. The machinery was setup and ready for use from 1 January 2052. The machinery is to be depreciated using the straight line method of depreciation.

Required tasks:

a. Prepare the general journal entries to record the depreciation and the transfer of the depreciation expense to profit and loss account for the years ended for 30 June 2052 and 30 June 2053.

Workings

Practice Questions

Questions 16-18: Revision depreciation calculations for the straight line method of depreciation.

Question 16

A business has provided the following information about a motor vehicle the entity owns.

- Historical Cost: \$5000.
- Useful Life: 4.
- Residual Value: 1,000.
- Motor vehicle Ready to use date: 31 January 2034.

Required tasks:

- a. Using the straight line method, calculate depreciation expense during the second accounting period.
- b. Using the straight line method, calculate depreciation expense during the first accounting period.

Workings

Question 17

A business has provided the following information about equipment the entity owns.

- Historical Cost: \$9000.
- Depreciation Rate: 15%
- NCA Ready to use date: 1 December 2035.

Required tasks:

- a. Using the straight line method, calculate depreciation expense during the third accounting period.

Workings

- b. Using the straight line method, calculate depreciation expense during the first accounting period.

Workings

c. Calculate the carrying value of the equipment as at 30 June 2038.

Workings

Question 18

A business has provided the following information about a non-current asset the entity owns.

- Historical Cost: \$25,000.
- Useful Life: 10 years.
- Residual Value: 7,000.
- NCA Ready to use date: 1 September 2029.

Required tasks:

a. Using the straight line method, calculate depreciation expense during the third accounting period.

Workings

b. Using the straight line method, calculate depreciation expense during the first accounting period.

Workings

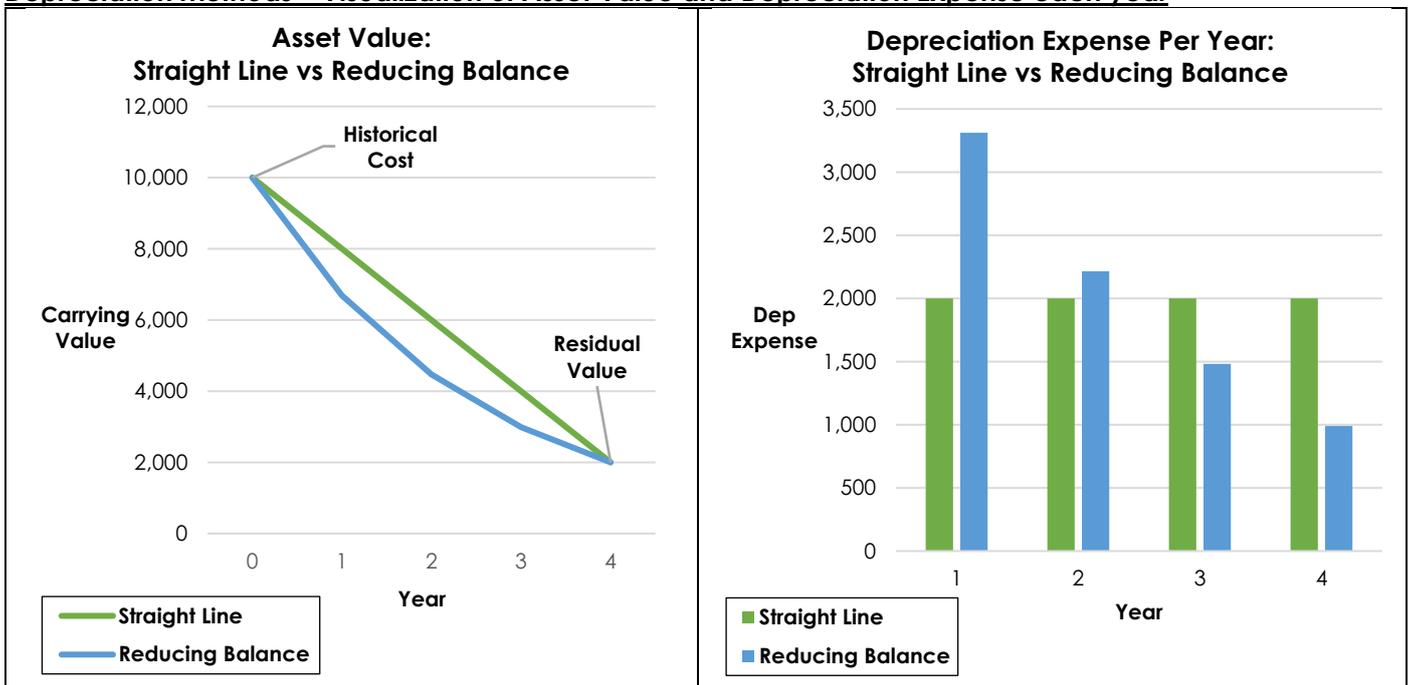
c. Calculate the carrying value of the NCA as at 30 June 2032.

Workings

Reducing Balance Depreciation Method

Reducing Balance Method	
Calculation	Depreciation expense = Carrying value x Depreciation Rate Carrying value = Historical cost – Accumulated Depreciation $\text{Depreciation rate} = \left[1 - \sqrt[n]{\frac{\text{Residual Value}}{\text{Original Cost}}} \right] \times 100$ n = Useful life Note: RBM Depreciation rate formula is not required in syllabus.
Depreciation expense	Higher in early years.
Use method when	<ul style="list-style-type: none"> Income generated by asset is higher in earlier years of useful life. Cause of depreciation is higher in earlier years of useful life.
Examples	<ul style="list-style-type: none"> Machinery. Motor vehicles. Computers.

Depreciation Methods – Visualization of Asset Value and Depreciation Expense each year



Note: Carrying Value = Historical Cost – Residual Value

Example 1 – Reducing Balance Method

A business purchased machinery on 15 March 2030. The machinery had an historical cost of \$12,000, a residual value of \$2,000 and a useful life of 5 years. The business will depreciate the machine at 30% per year. The machinery was ready to use from the 31 March 2030.

Required task:

Calculate the depreciation expense for the years ended 30 June 2030, 30 June 2031 and 30 June 2032.

Solution

Extension: Calculation of depreciation rate.

Reducing Balance Method depreciation questions should provide a depreciation rate as a percentage.

The depreciation rate can be calculated with the following formula. This has been demonstrated for extension purposes. The depreciation rate formula is not required in the syllabus.

$$\text{Depreciation rate} = \left[1 - \sqrt[n]{\frac{\text{Residual Value}}{\text{Original Cost}}} \right] \times 100$$

n = Useful life

$$= \left[1 - \sqrt[5]{\frac{2,000}{12,000}} \right] \times 100$$

= 30.12%

For simplicity's sake, in this calculation the depreciation rate used will be 30%.

Step 1 – Calculation of depreciation expense for a partial year.

The depreciation expense for the initial full year or part year is calculated by multiplying the **historical cost** by the depreciation rate. If the depreciation expense is being calculated for a partial year than the depreciation expense is multiplied by the portion of the year that has taken place. Partial years of depreciation normally take place during the first and last year of asset ownership.

The below diagram represents the months of the year the asset was ready for use.



$$\text{Partial Year Depreciation Expense} = \text{Historical Cost or Carrying Value} \times \text{Depreciation Rate} \times \left(\frac{\text{Months NCA was owned}}{12} \right)$$

Note: for the above calculation, historical cost is used to calculate the depreciation expense for the first period. Carrying value is used to calculate depreciation expense for the second period onwards.

Partial year depreciation expense for the year ended 30 June 2030 = $12,000 \times 0.3 \times (3/12)$
= 900

Step 2 – Calculation of depreciation expense for a full year

In following years, the depreciation expense is calculated by multiplying the **carrying value** by the depreciation rate. Carrying value is also known as carrying amount. The carrying value is the historical cost less the accumulated depreciation. This calculation can be laid out in the table set out below.

\$12,000	Historical Cost
\$900	Depreciation Expense (DE) for the year ended 30 June 2030
\$11,100	Carrying value (CV) at 30 June 2030
\$3,330	DE 30 June 2031
\$7,770	CV 30 June 2031
\$2,331	DE 30 June 2032
\$5,439	CV 30 June 2032

The workings for the above table are set out below.

$$\text{Depreciation Expense} = \text{Carrying Value} \times \text{Depreciation Rate}$$

$$\text{Carrying value} = \text{Historical cost} - \text{Accumulated Depreciation}$$

2030 Depreciation expense was calculated in the previous step.

$$\begin{aligned} \text{2030 Carrying value} &= 12,000 - 900 \\ &= 11,100 \end{aligned}$$

$$\begin{aligned} \text{2031 Depreciation expense} &= 11,100 \times 0.3 \\ &= 3,330 \end{aligned}$$

$$\begin{aligned} \text{2031 Carrying Value} &= 11,100 - 3,330 \\ &= 7,770 \end{aligned}$$

$$\begin{aligned} \text{2032 Depreciation expense} &= 7,770 \times 0.3 \\ &= 2,331 \end{aligned}$$

$$\begin{aligned} \text{2032 Carrying Value} &= 7,770 - 2,331 \\ &= 5,439 \end{aligned}$$

Note: the general journal and general ledger entries for reducing balance method are the same as the straight line method. The only difference between the two depreciation methods is the calculation process which was just demonstrated.

Practice Questions

Questions 19: Reducing Balance Method Theory.

Questions 20-21: Reducing Balance Method with full year ownership.

Questions 22-23: Reducing Balance Method with part year ownership.

Questions 24-25: Reducing Balance Method questions.

Questions 26-28: Revision depreciation calculations for the reducing balance method of depreciation.

Question 19

Describe the reducing balance depreciation method including:

- Describe depreciation expense when using this method.
- Describe when this method should be used.
- List examples of Non-Current Assets that should be depreciated with this method.

Question 20

A business purchased a motor vehicle with a historical cost of \$16,500 GST inclusive. The motor vehicle was ready for use on 1 July 2050. The business depreciates the motor vehicle at a rate of 15% per annum with the reducing balance method. Round depreciation expense calculations to the nearest dollar.

Required task:

- Calculate the depreciation expense for the years ended 30 June 2051, 2052 and 2053.

	Historical Cost
	Depreciation Expense (DE) for the year ended 30 June 2051
	Carrying value (CV) at 30 June 2051
	DE 30 June 2052
	CV 30 June 2052
	DE 30 June 2053
	CV 30 June 2053

- Prepare the general journal entry to record the depreciation expense for the year ended 30 June 2052.

Date	Details	Debit	Credit
30 Jun 2052	_____	_____	
	Accumulated Depreciation of Motor Vehicle Depreciation expense		_____

c. Prepare a balance sheet extract for the year ended 30 June 2052.

Workings

Balance Sheet (extract) as at 30 June 2052		
Non-Current Assets		
Motor Vehicle		
Accumulated Depreciation of Motor Vehicle		

Question 21

On 12 Jun 2043, a business purchased a machinery for \$7,500 exclusive of GST. The business was setup and ready to use on the 30 Jun 2043. The business depreciates the machinery at a rate of 20% per annum with the reducing balance method. Round depreciation expense calculations to the nearest dollar.

Required task:

a. Calculate the depreciation expense for the years ended 30 June 2044, 2045 and 2046.

	Historical Cost
	Depreciation Expense (DE) for the year ended 30 June 2044
	Carrying value (CV) at 30 June 2044
	DE 30 June 2045
	CV 30 June 2045
	DE 30 June 2046
	CV 30 June 2046

b. Prepare the accumulated depreciation general ledger account as at 30 Jun 2045.

Accumulated Depreciation of Machinery					
Date	Description	\$	Date	Description	\$

c. Prepare a balance sheet extract for the year ended 30 June 2046.

Balance Sheet (extract) as at 30 June 2046		
Non-Current Assets		

Practice Questions

Questions 22-23: Reducing Balance Method with part year ownership.

Question 22

A business purchased a motor vehicle on 19 January 2038 for \$24,000 + \$2,400 GST. The motor vehicle was ready for use on 31 January 2038. The business depreciates the motor vehicle at a rate of 10% per year. Round all calculations to the nearest dollar.

Required task:

a. Calculate the depreciation expense for the years ended 30 June 2038, 2039 and 2040.

b. Prepare the general journal entry to record the depreciation expense for 2040.

Date	Details	Debit	Credit

c. Prepare a balance sheet extract for the year ended 30 June 2038.

Balance Sheet (extract) as at 30 June 2038		
Non-Current Assets		

Question 23

A business purchased a computer on 23 September 2035 for \$3,200 + \$320 GST. The computer was ready for use on 1 October 2035. The business depreciates the computer at a rate of 15% per year. Round all calculations to the nearest dollar.

Required task:

a. Calculate the depreciation expense for the years ended 30 June 2036, 2037 and 2038.

b. Prepare the accumulated depreciation general ledger to record the depreciation expense for 2037.

Accumulated Depreciation of Computer					
Date	Description	\$	Date	Description	\$

c. Prepare a balance sheet extract for the year ended 30 June 2038.

Balance Sheet (extract) as at 30 June 2038		
Non-Current Assets		

Practice Questions

Questions 24-25: Reducing Balance Method questions.

Question 24

Big Ol Holes Pty Ltd digs very large holes requiring specialist equipment. On 15 June 2067 the business purchased equipment for \$20,900 GST inclusive. The cost of equipment transport was \$550 including GST. Transport insurance was purchased for \$15 plus GST. The equipment requires annual registration with a government construction organisation which costs \$300 + \$30 GST per year. A specialist laser sight was added to the equipment at a cost of \$400 + \$40 GST in parts and \$900 + \$90 GST in installation costs. The motor vehicle is to be depreciated at 15% per annum. The equipment was setup and ready for use from 31 July 2067. The motor vehicle is to be depreciated using the reducing balance method of depreciation.

Required tasks:

a. Prepare the general journal entries to record the depreciation and the transfer of the depreciation expense to profit and loss account for the years ended for 30 June 2068 and 30 June 2069.

Workings

	HC
	DE 30 June 2068
	CV 30 June 2068
	DE 30 June 2069
	CV 30 June 2069

Question 25

On 21 August 2048 a business purchased a computer for \$2,860 GST inclusive. The computer was transported at a cost of \$40 plus GST. The computer arrived in individual parts and required assembly at a cost of \$726 including GST. The business's logo was painted on the side of the computer at a total cost of \$462 GST inclusive. Software required for the computer will cost \$450 + \$45 per year in subscription fees. The computer is to be depreciated using the reducing balance method at a rate of 8% per year. The computer was setup and ready to use from 1 October 2048.

Required tasks:

a. Prepare the general journal entries to record the depreciation and the transfer of the depreciation expense to profit and loss account for the years ended for 30 June 2049 and 30 June 2050.

Workings

Practice Questions

Questions 26-28: Revision depreciation calculations for the reducing balance method of depreciation.

Question 26

A business has provided the following information regarding the machinery they currently use.

- Historical Cost: 5,500.
- Depreciation Rate: 10%.
- Machinery ready to use date: 1 Feb 2021.

Required tasks:

a. Calculate depreciation expense for the first two accounting periods using the reducing balance method.

	HC
	DE 30 June 2022
	CV 30 June 2022
	DE 30 June 2023
	CV 30 June 2023

b. Calculate the carrying value as at 30 June 2022.

Question 27

A business has provided the following information regarding their motorbike.

- Historical Cost: 24,600.
- Depreciation Rate: 12%.
- Motorbike ready to use date: 1 Nov 2042.

Required tasks:

a. Calculate depreciation expense for the years ended 30 June 2043, 2044 and 2045.

b. Calculate the carrying value as at 30 June 2044.

Question 28

A business has provided the following information regarding fixtures and fittings.

- Historical Cost: 78,000
- Depreciation Rate: 9%
- Fixtures and fittings ready to use date: 30 April 2079

Required tasks:

a. Calculate depreciation expense for the first three accounting periods.

b. Calculate the carrying value as at 30 June 2080.

Sale of Depreciable Asset – Introduction

The sale of an asset is processed and recorded in a “sale of asset” account. The original cost of the asset and the accumulated depreciation are transferred to this account which represents the carrying value. The cash received for the asset is transferred to the sale of asset account which represents the proceeds of sale. Once these accounts have been transferred it is possible to work out whether there the asset was over or under depreciated. Over or under depreciation leads to a gain or loss on sale.

Over/Under Depreciation

Over or under depreciation nature: At the time a depreciable asset is sold, the carrying value is compared to the proceeds of sale. This identifies the difference between:

- Estimated market value (residual value).
- Actual market value.

	Gain on sale	Loss on sale	No gain or loss on sale (rarely happens but here for theory extension)
Proceeds of Sale vs. Carrying Value	Proceeds of sale is more than carrying value. OR Carrying value is less than proceeds of sale.	Proceeds of sale is less than carrying value. OR Carrying value greater than proceeds of sale.	Proceeds of sale is equal to carrying value.
Over/under depreciation	Over depreciation.	Under depreciation.	N/A.
This means	Too much depreciation (over depreciation) has been subtracted from income whilst the business has owned the asset.	Too little depreciation (under depreciation) has been subtracted from income while the business has owned the asset.	The right amount of depreciation (under depreciation) has been subtracted from income while the business has owned the asset.

Example

On 31 October 2038, Crisp Couriers sold a motor vehicle for \$8,000 + \$800 GST. The historical cost was \$22,000, the residual value was \$2,000 and the useful life was 5 years. The business calculates depreciation using the straight line method and the annual depreciation expense was \$4,000.

The carrying value at the previous balance day of 30 June 2038 was \$5,000.

Required task:

Prepare the general journal and general ledger entries to record and process and record the sale of the asset.

Record the gain or loss on sale in the income statement.

Solution

Step 1 – Calculation of partial year Depreciation Expense at time of sale.

The depreciation expense must be calculated and recorded for the partial year of depreciation that has occurred from the previous balance day until the time of sale. The diagram below represents the period from balance day until the asset was sold.



Balance Day 30 June

$$\begin{aligned} \text{Part year depreciation expense} &= [(22,000 - 2,000) / 5] \times (4/12) \\ &= 4,000 \times (4/12) \\ &= 1,333 \end{aligned}$$

Step 2 - Recording of partial year Depreciation Expense at time of sale.

The depreciation expense is recorded using the same process demonstrated previously.

- Debit Depreciation of MV \$1,333 to increase expense account.
- Credit Accumulated Depreciation of MV \$1,333 to increase this contra asset account.

The balance b/d in the accumulated depreciation account was found by rearranging the carrying value formula. Given the carrying value was \$5,000 at the time of sale this must mean the accumulated depreciation of was \$17,000.

Carrying value = Historical cost – Accumulated Depreciation.

Accumulated Depreciation = Historical Cost – Carrying Value
 = \$22,000 - \$5,000
 = \$17,000

Therefore, the balance b/d of the Accumulated Depreciation of Motor Vehicle account was \$17,000.

Date	Details	Debit	Credit
31 Oct 2038	Depreciation of MV	1,333	
	Accumulated Depreciation of MV		1,333
	Depreciation Expense		

Depreciation of Motor Vehicle					
Date	Description	\$	Date	Description	\$
31 Oct 2038	Accumulated Depreciation of MV	1,333			

Accumulated Depreciation of Motor Vehicle					
Date	Description	\$	Date	Description	\$
			1 Jul 2038	Balance b/d	17,000
			31 Oct 2038	Depreciation of MV	1,333

Step 3 – Transfer of Historical Cost of NCA to Sale of Asset account.

The historical cost of the motor vehicle is transferred to the sale of asset account.

- Debit sale of asset \$22,000 to this working account.
- Credit motor vehicle \$22,000 to decrease this asset account.

The entry that is not bolded in the motor vehicle account would have been created at the time the NCA was purchased.

Date	Details	Debit	Credit
31 Oct 2038	Sale of Asset	22,000	
	Motor Vehicle		22,000
	Sale of Motor Vehicle		

Sale of Asset					
Date	Description	\$	Date	Description	\$
31 Oct 2038	Motor Vehicle	22,000			

Motor Vehicle					
Date	Description	\$	Date	Description	\$
1 Apr 2034	Cash at Bank	22,000	31 Oct 2038	Sale of Asset	22,000

Step 4 – Transfer of Accumulated Depreciation to Sale of Asset account.

The accumulated depreciation account is totalled and the balance is transferred to the sale of asset account.

- Debit Accumulated Depreciation of MV \$18,333 to decrease this contra asset account.
- Credit Sale of Asset \$18,333 to decrease this working account.

Date	Details	Debit	Credit
31 Oct 2038	Accumulated Depreciation of MV	18,333	
	Sale of Asset		18,333
	Accumulated Depreciation at sale of motor vehicle		

Accumulated Depreciation of Motor Vehicle					
Date	Description	\$	Date	Description	\$
31 Oct 2038	Sale of Asset	18,333	1 Jul 2038	Balance b/d	17,000
			31 Oct 2038	Depreciation of MV	1,333
		18,333			18,333

Sale of Asset					
Date	Description	\$	Date	Description	\$
31 Oct 2038	Motor Vehicle	22,000	31 Oct 2038	Acc Dep of MV	18,333

Step 5 – Proceeds of sale of asset.

The proceeds of the sale of the NCA are recorded in the cash at bank, sale of asset and GST payable accounts.

- Debit Cash at Bank \$8,800 to increase this asset account.
- Credit Sale of Asset \$8,000 to decrease this working account.
- Credit GST Payable \$800 to increase this liability account.

Note: The syllabus states that GST is not required for balance day adjustments such as depreciation. GST has been demonstrated in the below example for real world extension. However, you should not be required to use GST in balance day adjustment assessment questions. If ignoring GST at this step, then there would be no Credit GST entry and the Cash at Bank debit entry would be 8,000 to match the Sale of Asset entry.

Date	Details	Debit	Credit
31 Oct 2038	Cash at Bank	8,800	
	Sale of Asset		8,000
	GST Payable		800
	Proceeds of sale of asset		

Cash at Bank					
Date	Description	\$	Date	Description	\$
31 Oct 2038	Sale of Asset / GST Payable	8,800			

Sale of Asset					
Date	Description	\$	Date	Description	\$
31 Oct 2038	Motor Vehicle	22,000	31 Oct 2038	Acc Dep of MV	18,333
			31 Oct 2038	Cash at Bank	8,000

GST Payable					
Date	Description	\$	Date	Description	\$
			31 Oct 2038	Cash at Bank	800

Step 6 – Gain or Loss on Sale of Asset

The sale of asset account is now totalled and the gain or loss on sale is the difference between the proceeds of sale and carrying value. The carrying value is the historical cost less accumulated depreciation.

Gain or loss on sale = Proceeds of sale – Carrying value.

- Positive result = gain on sale = debit entry in sale of asset account.
- Negative result = loss on sale = credit entry in sale of asset account.

Alternatively, this is also found as the difference between the sale of asset account total.

- If the difference is made up with a debit entry = Gain on sale.
- If the difference is made up with a credit entry = Loss on sale.

Note: the debit and credit entries for these accounts are reversed if it is a loss on sale of asset.

Date	Details	Debit	Credit
31 Oct 2038	Sale of Asset	4,333	
	Gain on Sale of Asset		4,333
	Gain on sale of asset		

Sale of Asset					
Date	Description	\$	Date	Description	\$
31 Oct 2038	Motor Vehicle	22,000	31 Oct 2038	Acc Dep of MV	18,333
31 Oct 2038	Gain on Sale of Asset	4,333	31 Oct 2038	Cash at Bank	8,000
		26,333			26,333

Gain on Sale of Asset					
Date	Description	\$	Date	Description	\$
			31 Oct 2038	Sale of Asset	4,333

Step 7 – Gain on Sale of Asset to Profit and Loss Account

At balance day, the gain on sale of asset account is closed to the profit and loss account.

- Debit Gain on Sale of Asset 4,333 to close this income account.
- Credit Profit and Loss \$4,333 to this working account.

Note: the entry that is not bolded in the gain on sale of asset represents the original entry when the asset was sold.

Date	Details	Debit	Credit
30 Jun 2039	Gain on Sale of Asset	4,333	
	Profit and Loss		4,333
	Income transferred		

Gain on Sale of Asset					
Date	Description	\$	Date	Description	\$
30 Jun 2039	Profit and Loss	4,333	31 Oct 2038	Sale of Asset	4,333

Profit and Loss					
Date	Description	\$	Date	Description	\$
			30 Jun 2039	Gain on Sale of Asset	4,333

Step 8 – Gain or Loss on Sale of Asset in the Income Statement

The gain on sale of asset appears in the Add Other Income section of the income statement as demonstrated below.

Crisp Couriers Income Statement (Extract) for the year ended 30 June 2039	
Sales	50,000
Less Cost of Sales	22,000
Gross Profit	28,000
Add Other Income	
Gain on Sale of Motor Vehicle	4,333

Loss on Sale in the Income Statement Alternate Example Income Statement

If a loss on sale of asset had occurred, this would have appeared in the income statement under the less other expenses categories of either selling and distribution expenses or general and administration expenses depending on what the non-current asset was associated with.

- A loss on sale of a motor vehicle use for sales or distribution would have been under selling and distribution expenses. This is demonstrated below.
- A loss on sale of office furniture could appear under general and administration expenses.

Example Loss on Sale Business Income Statement (Extract) for the year ended 30 June 2050	
Less Other Expenses	
Selling and Distribution Expenses	
Loss on Sale of Motor Vehicle	3,000

Practice Questions

Questions 29-32: Gain or Loss on Sale.

Question 33: Calculation of partial year of depreciation at time of sale of depreciable asset.

Questions 34-39: Calculation of gain or loss on sale using sale of asset ledger account.

Questions 40-42: Sale of Asset using Straight Line Method.

Questions 43-44: Sale of Asset using Reducing Balance Method.

Questions 45-51: Depreciation theory review.

Note: The syllabus does not require balance day adjustments calculations to include GST. The solutions for this section show where the GST would occur for real world extension. There are also notes beneath the relevant journals and ledgers to show what these would look like without GST.

Question 29

Describe gain on sale on an asset.

Question 30

Describe loss on sale of an asset.

Question 31

On 31 October 2035, a business sold a motor vehicle for \$6,600 GST inclusive. The historical cost of the motor vehicle was \$18,000 and the accumulated depreciation was \$15,000.

Required task:

a. Prepare the sale of asset and gain or loss on sale of asset ledger account.

Note: In more elaborated questions later in this chapter you will be required to calculate the depreciation expense for the final period that the asset was sold. The final year's depreciation expense will contribute to the accumulated depreciation expense and also be transferred to the profit and loss ledger account.

Sale of Asset					
Date	Description	\$	Date	Description	\$
31 Oct 2035			31 Oct 2035	Accumulated Depreciation of MV	15,000

Date	Description	\$	Date	Description	\$

Question 32

On 1 March 2047, a business sold office equipment for \$1,200 GST exclusive. The historical cost of the office equipment was \$8,000 and the accumulated depreciation was \$6,300.

Required task:

a. Prepare the sale of asset and gain or loss on sale of asset ledger account.

Sale of Asset					
Date	Description	\$	Date	Description	\$

_____ on Sale of Asset					
Date	Description	\$	Date	Description	\$

Practice Questions

Question 33: Calculation of partial year of depreciation at time of sale of depreciable asset.

Question 33

For each of the below tasks, calculate the number of months from balance to the date the asset was sold. Use this information to calculate the partial depreciation expense.

Note: The first task has been completed as an example.

Required tasks:

a. Calculate the depreciation expense from 30 June 2048 to 30 September 2048 when the non-current asset was sold. Annual depreciation expense is \$3,600.



Workings

3 months from balance date.

$$\text{Depreciation expense} = 3,600 \times (3/12) \\ = \$900$$

Therefore, the depreciation expense from 30 June to 30 September is \$900.

b. Calculate the depreciation expense from 30 June 2031 to 28 February 2032 when the non-current asset was sold. Annual depreciation expense is \$6,000.



Workings

c. Calculate the depreciation expense from 30 June 2060 to 1 December 2060 when the non-current asset was sold. Annual depreciation expense is \$1,800.



Workings

c. Calculate the depreciation expense from 30 June 2096 to 1 June 2097 when the non-current asset was sold. Annual depreciation expense is \$12,600.



Workings

e. Calculate the depreciation expense from 30 June 2084 to 30 April 2084 when the non-current asset was sold. Annual depreciation expense is \$930.



Workings

f. Calculate the depreciation expense from 30 June 2077 to 30 July 2077 when the non-current asset was sold. Annual depreciation expense is \$780.



Workings

g. Calculate the depreciation expense from 30 June 2088 to 1 May 2089 when the non-current asset was sold. Annual depreciation expense is \$8,880.



Workings

Practice Questions

Questions 34-39: Calculation of gain or loss on sale using sale of asset ledger account.

Sale of Asset ledger account for workings

The Sale of Asset ledger account has been demonstrated below. When completing these questions fill in the known values in the ledger account.

Sale of Asset					
Date	Description	\$	Date	Description	\$
	NCA	X		Accumulated Depreciation of NCA	X
	Gain on Sale of MV	X		Cash at Bank	X
				Loss on Sale of Asset	X
		Total			Total

Tips

- NCA figure: This represents the historical cost of the NCA. I.e. this appears here because the NCA is no longer owned by the business because it has been sold.
- Cash at Bank figure: This represents the proceeds of sale of the NCA.
- Accumulated Depreciation figure: This represents the accumulated depreciation at the time of sale.
- Gain or loss on sale figure: This is calculated as demonstrated below.

Gain or loss on sale = Proceeds of sale – Carrying value.

- Positive result = gain on sale = debit entry in sale of asset account.
- Negative result = loss on sale = credit entry in sale of asset account.

Note: Carrying value = Historical cost – Accumulated Depreciation.

Alternatively, this is also found as the difference between the sale of asset account total.

- If the difference is made up with a debit entry = Gain on sale.
- If the difference is made up with a credit entry = Loss on sale.

Elaborated questions

When completing sale of asset general ledger and general journal questions in more elaborated questions later, you may find it easier to complete the sale of asset ledger account first. This is because the sale of asset account can act as a prompt for which other accounts require entries due to the double entry accounting principle. This account will also act as a reminder to complete the general journal entry for the gain or loss on sale as well calculation of the value for this entry.



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Question 34

The following information has been provided by a business regarding an asset that has recently been sold.

- Proceeds of sale of motor vehicle: \$7,000.
- Purchase price of motor vehicle: \$35,000.
- Accumulated Depreciation of motor vehicle at time of sale: \$19,000.

Required task:

Calculate the gain or loss on sale of the motor vehicle.

Sale of Asset					
Date	Description	\$	Date	Description	\$
	Motor Vehicle			Accumulated Depreciation of MV	19,000
				Cash at Bank	7,000

Therefore the _____ (gain or loss) on sale of fixture of fittings is _____.

Question 35

The following information has been provided by a business regarding an asset that has recently been sold.

- Proceeds of sale of fixtures and fittings: \$11,000 GST inclusive.
- Purchase price of fixtures and fittings: \$10,000 GST exclusive.
- Accumulated Depreciation of fixtures and fittings at time of sale: \$3,500.

Required task:

Calculate the gain or loss on sale of the Fixtures and Fittings.

Sale of Asset					
Date	Description	\$	Date	Description	\$

Therefore the _____ (gain or loss) on sale of fixture of fittings is _____.

Question 36

The following information has been provided by a business regarding an asset that has recently been sold.

- Proceeds of sale of machinery: \$6,500 GST exclusive.
- Purchase price of machinery: \$19,000.
- Carrying value of machinery: \$8,000.

Required task:

Calculate the gain or loss on sale of the machinery.

Tip: The carrying value equation can be rearranged to find the accumulated depreciation.

Sale of Asset					
Date	Description	\$	Date	Description	\$

Therefore the _____ (gain or loss) on sale of machinery is _____.

Question 37

The following information has been provided by a business regarding an asset that has recently been sold.

- Proceeds of sale of equipment: \$800 GST exclusive.
- Purchase price of equipment: \$6,000.
- Carrying value of equipment: \$2,000.

Required task:

Calculate the gain or loss on sale of the equipment.

Sale of Asset					
Date	Description	\$	Date	Description	\$

Therefore the _____ (gain or loss) on sale of equipment is _____.

Question 38

The following information has been provided by a business regarding an asset that has recently been sold.

- Proceeds of sale of office furniture: \$1,600 GST exclusive.
- Purchase price of office furniture: \$3,800 GST exclusive.
- Accumulated Depreciation of office furniture at previous balance day: \$2,800.
- Part year depreciation expense of office furniture for the period the office furniture was sold \$300.

Required task:

Calculate the gain or loss on sale of the office furniture.

Sale of Asset					
Date	Description	\$	Date	Description	\$

Therefore the _____ (gain or loss) on sale of office furniture is _____.

Question 39

The following information has been provided by a business regarding an asset that has recently been sold.

- Proceeds of sale of machinery: \$97,680 GST inclusive.
- Purchase price of machinery: \$295,000 GST exclusive.
- Accumulated Depreciation of machinery at previous balance day: \$180,500.
- Part year depreciation expense of machinery for the period the machinery was sold \$18,700.

Required task:

Calculate the gain or loss on sale of the machinery.

Sale of Asset					
Date	Description	\$	Date	Description	\$

Therefore the _____ (gain or loss) on sale of office furniture is _____.

Practice Questions

Questions 40-42: Sale of Asset using Straight Line Method.

Question 40

On 15 July 2030, a business purchased machinery for \$16,000 + \$1,600 GST. The machinery had a useful life of 8 years and a residual value of \$4,000. The machinery was setup and ready for use on 31 July 2030. The machinery is depreciated using the straight line method of depreciation. The machinery was sold on the 31 August 2032 for \$13,500 GST exclusive.

Required task:

a. Calculate the depreciation expense for the years ended 30 June 2031, 2032 and 2033.

Workings

b. Prepare the general ledger entries to record the purchase, depreciation and sale of the non-current asset. Only prepare the profit and loss account for the year the asset was sold.

Machinery					
Date	Description	\$	Date	Description	\$

GST Payable					
Date	Description	\$	Date	Description	\$

Note: if ignoring GST, the GST Payable ledger account would not be required.

Cash at Bank					
Date	Description	\$	Date	Description	\$

Depreciation of Machinery					
Date	Description	\$	Date	Description	\$

Accumulated Depreciation of Machinery					
Date	Description	\$	Date	Description	\$

Sale of Asset					
Date	Description	\$	Date	Description	\$

_____ on Sale of Asset					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Question 41

On 21 December 2045, a business purchased office furniture for \$19,800 GST inclusive. The office furniture was setup and ready for use from 31 December 2045. The office furniture had a useful life of 6 years and a residual value of \$3,000. On 30 November 2047, the business sold the office furniture for \$10,500 GST exclusive.

Required task:

a. Calculate the depreciation expense for the years ended 30 June 2046, 2047 and 2048.

Workings

b. Prepare the general ledger entries to record the purchase, depreciation and sale of the non-current asset. Only prepare the profit and loss account for the year the asset was sold.

Office Furniture					
Date	Description	\$	Date	Description	\$

GST Payable					
Date	Description	\$	Date	Description	\$

Note: if ignoring GST, the GST Payable ledger account would not be required.

Cash at Bank					
Date	Description	\$	Date	Description	\$

Depreciation of Office Furniture					
Date	Description	\$	Date	Description	\$

Accumulated Depreciation of Office Furniture					
Date	Description	\$	Date	Description	\$

Sale of Asset					
Date	Description	\$	Date	Description	\$

_____ on Sale of Asset					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Question 42

On 18 April 2039, a business purchased fixtures and fittings for \$8,000 GST exclusive. The fixtures and fittings were setup and ready for use from 1 May 2039. The fixtures and fittings have a useful life of 5 years and residual value of \$500. The fixtures and fittings are to be depreciated using the straight line method of depreciation. The fixtures and fittings were sold on the 31 July 2040 for \$6,500 GST exclusive.

Required task:

a. Calculate the depreciation expense for the years ended 30 June 2039, 2040 and 2041.

Workings

b. Prepare the general ledger entries to record the purchase, depreciation and sale of the non-current asset. Only prepare the profit and loss account for the year the asset was sold.

Fixtures and Fittings					
Date	Description	\$	Date	Description	\$

GST Payable					
Date	Description	\$	Date	Description	\$

Note: if ignoring GST, the GST Payable ledger account would not be required.

Cash at Bank					
Date	Description	\$	Date	Description	\$

Depreciation of Fixtures and Fittings					
Date	Description	\$	Date	Description	\$

Accumulated Depreciation of Fixtures and Fittings					
Date	Description	\$	Date	Description	\$

Sale of Asset					
Date	Description	\$	Date	Description	\$

_____ on Sale of Asset					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Practice Questions

Questions 43-44: Sale of Asset using Reducing Balance Method.

Question 43

On 15 August 2046, a business purchased a motor vehicle for \$20,000 GST exclusive. The motor vehicle was ready for use on 31 August 2046. The motor vehicle was depreciated at 15% per annum using the reducing balance method. On 1 April 2049, the motor vehicle was sold for \$17,600 GST inclusive.

a. Calculate the depreciation expense for the years ended 30 June 2047, 2048 and 2049.

Note: the journal and ledger entries follow the same process as the straight line method. These can be practiced here to build confidence if required.

Workings

	Historical Cost
	Depreciation Expense (DE) for the year ended 30 June 2047
	Carrying value (CV) at 30 June 2047
	DE 30 June 2048
	CV 30 June 2048
	DE 30 June 2049
	CV 30 June 2049

b. Prepare the sale of asset ledger account at time of sale of the asset.

Workings

Sale of Asset					
Date	Description	\$	Date	Description	\$
1 Mar 2049	Motor Vehicle	20,000			
			1 Mar 2049	Cash at Bank	16,000

Question 44

On 25 February 2032, a business purchased Machinery for \$7,500 GST exclusive. The machinery was setup and ready for use on 28 February 2032. The machinery was depreciated at 10% per annum using the reducing balance method. The machinery was sold on 1 Jun 2035 for \$900 plus GST.

a. Calculate the depreciation expense for the years ended 30 June 2032, 2033, 2034 and 2035.

Workings

b. Prepare the sale of asset ledger account at time of sale of the asset.

Sale of Asset					
Date	Description	\$	Date	Description	\$

Question 48

The depreciation expense is _____ in successive years when using the reducing balance method of depreciation.

- a. The same
- b. More
- c. Less
- d. Comparable

Question 49

Recording the asset at the price it was purchased and having accumulated depreciation as a separate entry follows this accounting principle.

- a. Going concern
- b. Historical cost
- c. Accounting entity assumption
- d. Faithful representation

Question 50

The reducing balance method of depreciation should not be used for the following asset

- a. Machinery
- b. Computers
- c. Buildings
- d. Computers

Question 51

A gain on sale of asset means that:

- a. The asset has been over depreciated.
- b. The asset has been under depreciated.
- c. The correct amount of depreciation has been applied.
- d. Carrying amount greater than proceeds of sale.



Niseko, Japan.

Depreciation and Sale of Asset Test Questions

While any of the practical and theory that is in this chapter may be assessed, the following series of questions have been included to extend students application of depreciation and sale of asset practical skills. Tips are given throughout this section to scaffold new practical steps relevant for certain questions.

Practice Questions

Questions 52-53: Depreciation of multiple non-current assets.

Questions 54-55: Sale of non-current asset and depreciation of multiple non-current assets.

Questions 56-59: Trade in of non-current assets.

Question 52

Mike's Motor has provided the following financial information as at 30 June 2046.

Mike's Motors Balance Sheet (extract) As at 30 June 2046		
Non-Current Assets		
Motor Vehicles	70,000	
Accumulated Depreciation of Motor Vehicles	(18,000)	52,000

Additional information:

- The business calculates depreciation on motor vehicles using the straight line method.
- The existing motor vehicles depreciate by \$7,200 per year.
- On 31 December 2046, the business purchased a new motor vehicle on credit with a historical cost of \$24,000, a useful life of 10 years and a residual value of \$4,000. The motor vehicle was setup and ready to use on the same day.

Required tasks:

a. Calculate the depreciation of the motor vehicles for the year ended 30 June 2047.

Workings

b. Prepare the motor vehicles, depreciation of motor vehicles and accumulated depreciation of motor vehicles general ledger accounts for the year ended 30 June 2047.

Motor Vehicles					
Date	Description	\$	Date	Description	\$

Question 53

A business has provided the following financial information for the year ended 30 June 2052.

- The historical cost of existing equipment is \$63,000.
- Accumulated depreciation of existing equipment \$27,000.

Additional information:

- The business depreciates equipment using the reducing balance method of depreciation at a rate of 15% per year.
- On 1 September 2052, the business purchased new equipment for \$17,000 and paid cash.

Required tasks:

a. Calculate the depreciation of the motor vehicles for the year ended 30 June 2053.

Workings

b. Prepare the equipment, depreciation of equipment and accumulated depreciation of equipment general ledger accounts for the year ended 30 June 2053.

Equipment					
Date	Description	\$	Date	Description	\$

Depreciation of Equipment					
Date	Description	\$	Date	Description	\$

Accumulated Depreciation of Equipment					
Date	Description	\$	Date	Description	\$

Practice Questions

Questions 54-55: Sale of non-current asset and depreciation of multiple non-current assets.

Question 54

Ralph's Roof Plumbing Balance Sheet (extract) As at 30 June 2040		
Non-Current Assets		
Machinery	26,000	
Accumulated Depreciation of Machinery	(6,000)	20,000

Additional information:

- All machinery is depreciated using the reducing balance method of depreciation at a rate of 10% per year.
- On 30 September 2040 machinery with a historical cost of \$10,000 and accumulated depreciation at 30 June 2040 of \$1,800 was sold for \$5,900.
- New machinery was purchased with cash and ready to use on 1 December 2040 with a historical cost of \$12,000.

Required tasks:

a. Calculate the depreciation of machinery for the year ended 30 June 2041.

Tips	<ul style="list-style-type: none">• You will need to calculate the value of the depreciation expense and accumulated depreciation for the asset that was sold.• You will also need to calculate the depreciation for the asset that was not sold for the full year and also the depreciation of the new asset for the part year.
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Workings

b. Prepare the machinery, depreciation of machinery, accumulated depreciation of machinery and sale of asset general ledger accounts for the year ended 30 June 2041.

Machinery					
Date	Description	\$	Date	Description	\$

Depreciation of Machinery					
Date	Description	\$	Date	Description	\$

Accumulated Depreciation of Machinery					
Date	Description	\$	Date	Description	\$

Sale of Asset					
Date	Description	\$	Date	Description	\$

d. Complete the balance sheet extract as at 30 June 2041.

Balance Sheet (extract) As at 30 June 2041		
Non-Current Assets		
Machinery		
Accumulated Depreciation of Machinery		

Question 55

The following information was extracted from the balance sheet of a business as at 30 June 2067.

- Fixtures and fittings \$15,000.
- Carrying value of fixture and fittings \$6,000.

Additional information:

- On 28 February 2068, the business purchased new fixtures and fittings for \$7,400.
- On 1 May 2068, the business received \$3,300 cash for fixtures and fittings with a historical cost of \$4,200 and accumulated depreciation at 30 June 2067 of \$1,100.
- The business depreciates fixtures and fittings using the straight line method of depreciation at a rate of 5% per year.

Required tasks:

a. Calculate the depreciation of fixtures and fittings for the year ended 30 June 2068.

Workings

b. Prepare the fixtures and fittings, depreciation of fixtures and fittings, accumulated depreciation of fixtures and fittings and sale of asset general ledger accounts for the year ended 30 June 2068.

Fixtures and Fittings					
Date	Description	\$	Date	Description	\$

Depreciation of Fixtures and Fittings					
Date	Description	\$	Date	Description	\$

Accumulated Depreciation of Fixtures and Fittings					
Date	Description	\$	Date	Description	\$

Sale of Asset					
Date	Description	\$	Date	Description	\$

d. Complete the balance sheet extract as at 30 June 2068.

Balance Sheet (extract) As at 30 June 2068		
Non-Current Assets		
Fixtures and Fittings		
Accumulated Depreciation of Fixtures and Fittings		

Practice Questions

Questions 56-59: Trade in of non-current assets.

Question 56

A business has provided the following information as at 30 June 2055.

- Motor Vehicle \$43,000.
- Accumulated Depreciation of Motor Vehicle \$15,000.

Additional information:

- The business traded in its motor vehicle on 1 January 2056. The value of the new motor vehicle was \$48,000 and the trade in price received was \$30,000. The remaining amount to be paid was paid in cash.
- The business depreciates its motor vehicles using the straight line method of depreciation at a rate of 10% per year.

Required tasks

a. Calculate the depreciation expense for the motor vehicles for the year ended 30 June 2056.

Workings

b. Prepare the motor vehicle, depreciation of motor vehicle, accumulated depreciation of motor vehicle and sale of asset general ledger accounts for the year ended 30 June 2056.

Tips	<ul style="list-style-type: none"> • It is always recommended when working on difficult questions to complete parts of the question in the order of what you feel confident completing. • The balance c/d for 30 June 2041 of the motor vehicle account will be the value of the new motor vehicle given the previous motor vehicle was sold and there is now only one motor vehicle. • The motor vehicle account is credited with the value of the motor vehicle that was sold. • The motor vehicle account is debited with two entries, these two values add up to the total value of the new motor vehicle. <ul style="list-style-type: none"> ○ One debit entry references the 'sale of asset account' to represent the trade in value received for the previous motor vehicle. I.e., \$30,000. ○ One debit entry references the 'cash at bank' to represent the cash paid for the new motor vehicle. I.e., 48,000 – 30,000 = \$18,000. • The sale of asset account has a debit and credit entry that reference the motor vehicle account: <ul style="list-style-type: none"> ○ The debit value that references the motor vehicle account is the value of the motor vehicle that was sold. ○ The credit value that references the motor vehicle account is the value of the trade in received for the motor vehicle.
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Note: Values have been included in the Motor Vehicle ledger account as a hint. You still need to enter the debit values that reference the 'sale of asset' and 'cash at bank' accounts.

Motor Vehicle					
Date	Description	\$	Date	Description	\$
1 Jul 2055	Balance	43,000	1 Jan 2056	Sale of Asset	43,000
1 Jan 2056	Sale of Asset		30 June 2056	Balance c/d	48,000
1 Jan 2056	Cash at Bank				
1 Jul 2056	Balance b/d	48,000			

Depreciation of Motor Vehicle					
Date	Description	\$	Date	Description	\$

Accumulated Depreciation of Motor Vehicle					
Date	Description	\$	Date	Description	\$

Sale of Asset					
Date	Description	\$	Date	Description	\$

d. Complete the balance sheet extract as at 30 June 2056.

Balance Sheet (extract) As at 30 June 2056		
Non-Current Assets		
Motor Vehicle		
Accumulated Depreciation of Motor Vehicle		

Question 57

A business has provided the following information.

Jane's Jumpers Balance Sheet (extract) As at 30 June 2071		
Non-Current Assets		
Machinery	137,000	
Accumulated Depreciation of Machinery	(27,000)	110,000

Additional information:

- The business traded in all machinery on 31 August 2071. The new machinery was valued at \$170,000 and the trade in price received was \$100,000. The remaining amount was purchased on credit.
- The business depreciates its machinery using the reducing balance method of depreciation at a rate of 15% per year.

Required tasks

a. Calculate the depreciation expense for the machinery for the year ended 30 June 2072.

Workings

b. Prepare the machinery, depreciation of machinery, accumulated depreciation of machinery and sale of asset general ledger accounts for the year ended 30 June 2072.

Machinery					
Date	Description	\$	Date	Description	\$

Depreciation of Machinery					
Date	Description	\$	Date	Description	\$

Accumulated Depreciation of Machinery					
Date	Description	\$	Date	Description	\$

Sale of Asset					
Date	Description	\$	Date	Description	\$

d. Complete the balance sheet extract as at 30 June 2072.

Jane's Jumpers Balance Sheet (extract) As at 30 June 2072		
Non-Current Assets		
Machinery		
Accumulated Depreciation of Machinery		

Question 58

A business has provided the following information as at 30 June 2063.

- Equipment: \$70,000.
- Accumulated Depreciation of Equipment: \$30,000.

Additional information:

- The business traded in equipment with a historical cost of \$15,000 on 31 Jan 2064. The accumulated depreciation of this equipment was \$9,000 at 30 June 2063. The new equipment was valued at \$30,000 and the trade in price received was \$10,000. The remaining amount was paid for with cash.
- The business depreciates its equipment using the reducing balance method of depreciation at a rate of 8% per year.

Tips	<ul style="list-style-type: none"> • In this question, only a portion of the total non-current asset that was originally represented in the financial information has been traded in.
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Required tasks

a. Calculate the depreciation expense for the equipment for the year ended 30 June 2064.

Workings

b. Prepare the equipment, depreciation of equipment, accumulated depreciation of equipment and sale of asset general ledger accounts for the year ended 30 June 2064.

Equipment					
Date	Description	\$	Date	Description	\$

Depreciation of Equipment					
Date	Description	\$	Date	Description	\$

Accumulated Depreciation of Equipment					
Date	Description	\$	Date	Description	\$

Sale of Asset					
Date	Description	\$	Date	Description	\$

d. Complete the balance sheet extract as at 30 June 2064.

Balance Sheet (extract) As at 30 June 2064		
Non-Current Assets		
Machinery		
Accumulated Depreciation of Machinery		

Question 59

A business has provided the following information as at 30 June 2049.

- Office Furniture: \$40,000.
- Carrying Value of Office Furniture: \$22,000.

Additional information:

- The business traded in office furniture with a historical cost of \$10,000 on 1 April 2050. The carrying value of this office furniture on 30 June 2049 was \$2,000. The new office furniture was valued at \$15,000 and the trade in price received was \$6,000. The remaining amount was paid for on credit.
- The business depreciates its motor vehicles using the straight line method of depreciation at a rate of 10% per year.

Required tasks

a. Calculate the depreciation expense for the machinery for the year ended 30 June 2050.

Workings

b. Prepare the office furniture, depreciation of office furniture, accumulated depreciation of office furniture and sale of asset general ledger accounts for the year ended 30 June 2050.

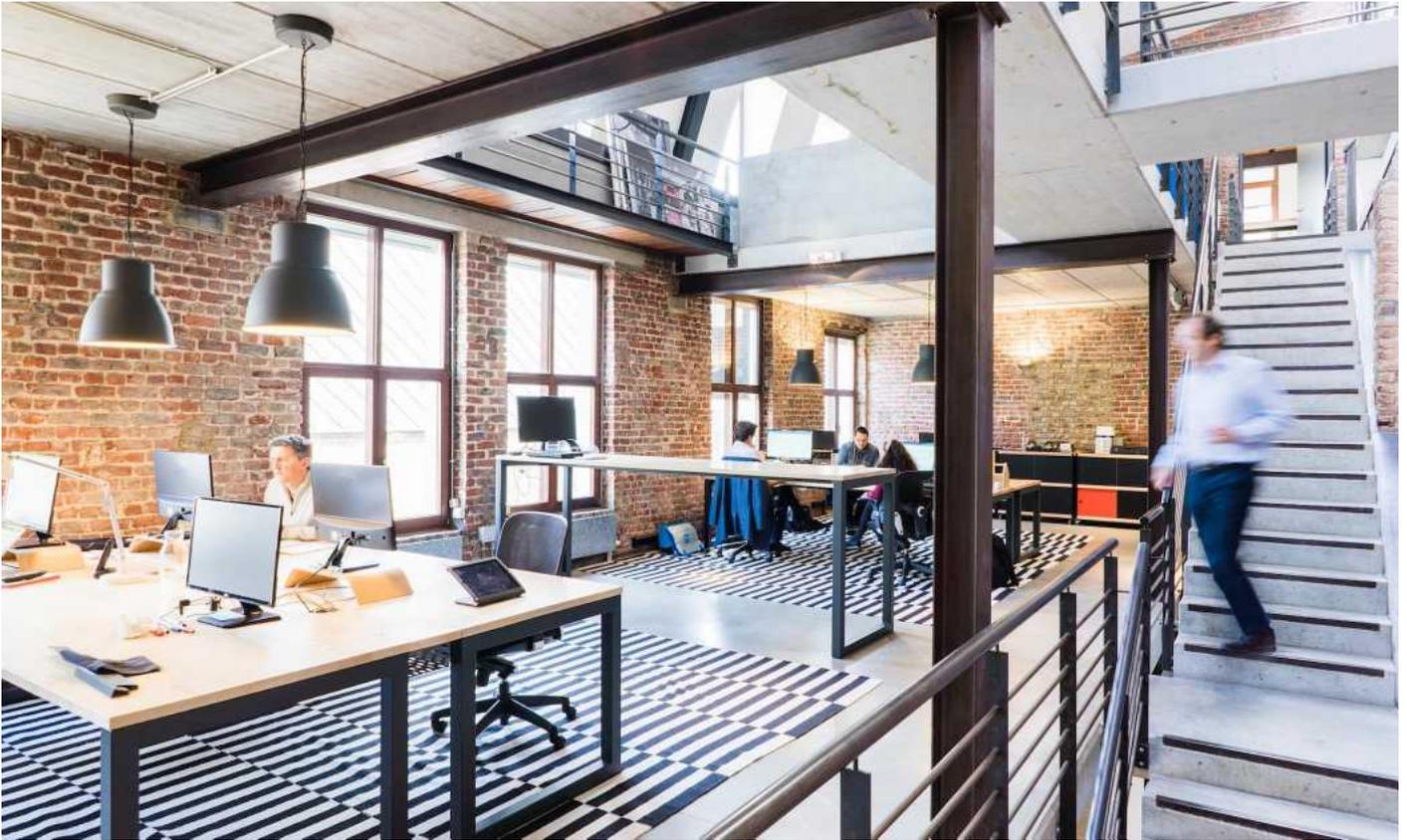
Office Furniture					
Date	Description	\$	Date	Description	\$

Depreciation of Office Furniture					
Date	Description	\$	Date	Description	\$

Accumulated Depreciation of Office Furniture					
Date	Description	\$	Date	Description	\$

Sale of Asset					
Date	Description	\$	Date	Description	\$

14. Balance Day Adjustments



Activate Prior Knowledge

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

<p>A business pays its rent in advance every six months. How would the amount of prepaid rent need to be adjusted on balance day?</p>	
<p>Employees are paid once a fortnight. On balance day how would you record one week of wages owing?</p>	
<p>A dance studio is paid for four months of lessons in advance. By balance day some of these lessons have been provided. What adjustment would need to take place in the accounting records?</p>	

Balance Day Adjustments – Syllabus

Syllabus – Unit 2	
Balance Day Adjustments	<p>Financial systems and fundamental principles</p> <ul style="list-style-type: none">• 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 <p>Recording, processing and communicating financial information</p> <ul style="list-style-type: none">• manual preparation of general journal and ledger entries for balance day adjustments (asset and liability method only) to prepare financial reports (GST not included)<ul style="list-style-type: none">▪ manual preparation of closing general journal entries

Balance Day Adjustments – Introduction

The accrual accounting system records income and expenses when transactions occur, regardless of when the cash is transferred. Balance day adjustments are carried out on the last day of an accounting period to allocate the correct profit and loss to the relevant accounting period. Balance day adjustments correct the figures in the balance sheet and income statement. This process will require entries in the general journal and general ledger.

Balance Day Adjustments for this course include:

- Prepaid Expenses.
- Stock of Supplies.
- Accrued Expense.
- Unearned Income / Income Received in Advance.
- Accrued Income.
- Depreciation.
- Doubtful Debts.

This chapter focuses on the calculation, recording and processing of balance day adjustments. The next chapter focuses on the preparation of financial statements with balance day adjustments.

Note: The syllabus states that GST is not required for balance day adjustments. GST has been demonstrated in some examples for real world extension. However, you should not be required to use GST in balance day adjustment assessment questions.



View from Prague Castle, Prague, Czech Republic.

Cash and Accrual Accounting – Summary Table

Financial Statements	Cash Accounting	Accrual Accounting
Income recognised / recorded	Income recognized when the cash is received.	Income recognised when the transaction occurs (income earned). The cash may or may not have been received yet.
Expenses recognised / recorded	Expenses recognised when the cash is paid.	Expenses recognised when the transaction occurs (expense incurred). The cash may or may not have been paid yet.

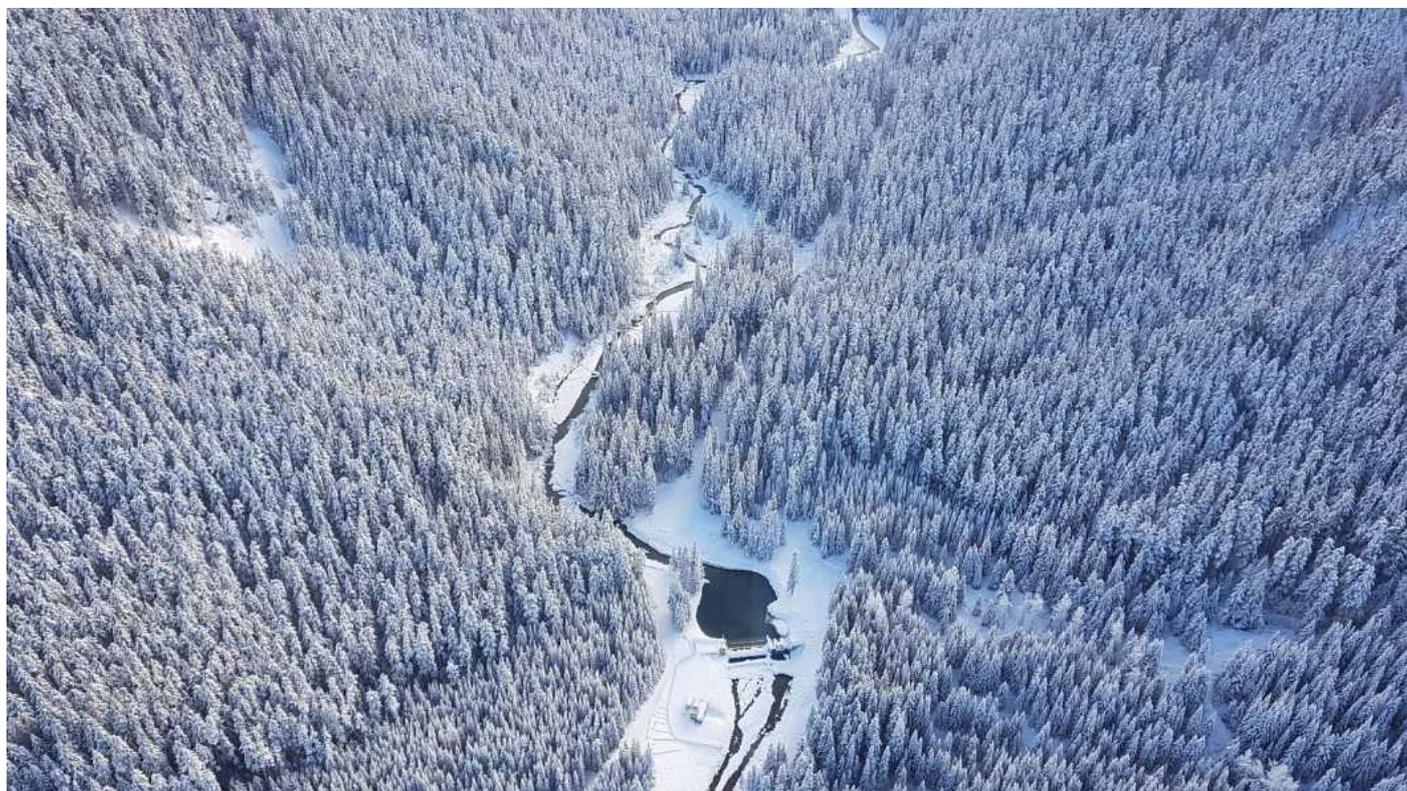
Extension: Recognition process

The following information is extension and not in the syllabus. An AASB Conceptual Framework concept that is particularly relevant to balance day adjustments is the recognition process. This information about the recognition process has been adapted from section 5.4 of the Conceptual Framework.

In simple terms, the recognition process refers to how for each balance day adjustments an asset or liability account is adjusted which then modifies either an income or expense account. The recognition process links the financial statements (balance sheet and income statement) because the recognition of one item (or a change in its carrying amount) requires the recognition or derecognition of one or more other items (or changes in the carrying amount of one or more other items). For example:

- The recognition of income occurs at the same time as:
 - The initial recognition of an asset, or an increase in the carrying amount of an asset; or
 - The recognition of a liability or a decrease in the carrying amount of a liability.
- The recognition of expenses occurs at the same time as:
 - The initial recognition of a liability, or an increase in the carrying amount of a liability; or
 - The recognition of an asset, or a decrease in the carrying amount of an asset.

The "recognition process that creates the account" is included in the summary table of each balance day adjustment as extension. This section of text is clarification of what this means.



Peak to Peak glass bottom gondola, Whistler, Canada.

Prepaid Expenses and Stock of Supplies

Prepaid expenses and stock of supplies are processed similarly. Both are current asset accounts that are updated to record the amount of an expense that has been used during a period.

Prepaid expenses are services that have been paid for in advance. A portion of the prepaid expense is used during an accounting period, which is adjusted to an expense account on balance day. Examples of prepaid expenses include prepaid advertising, prepaid rent, prepaid telephone etc.

Stock of supplies are office supplies that have been purchased for use within the next 12 months. A portion of the stock of supplies is used during an accounting period, which is adjusted to an expense account on balance day. Examples of stock of supplies include cleaning supplies, stationery supplies etc.

Theory		Prepaid expenses / Stock of Supplies
Nature	Conceptual Framework category of original account	Current Asset.
	How this account meets the conceptual framework definition?	<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>
Accounts Created	Accounts created	Expense.
	Recognition process that creates the account	Derecognition of current asset.
Purpose (of the adjusting entry)	Purpose overview	To record expenses consumed at balance date.
	Effect on Balance Sheet	<ul style="list-style-type: none"> • Current assets decreased.
	Effect on Income Statement	<ul style="list-style-type: none"> • Expenses increased. • Profit decreased.
	Effect on balance sheet if not accounted for	<ul style="list-style-type: none"> • Current assets overstated.
	Effect on income statement if not adjusted on balance day	<ul style="list-style-type: none"> • Expense understated. • Profit overstated.

Example

Wheatbelt Farm Supplies has supplied the following information.

- On 1 March 2042, the business paid a local radio station \$3,600 excluding GST for 6 months of advertising.

Required task:

- Prepare the general journal and general ledger entries to adjust the prepaid advertising account as at 30 June 2042.
- Demonstrate prepaid advertising on the balance sheet as at 30 June 2042.

Solution

Step 1 – Purchase of Prepaid Advertising.

The purchase of Prepaid Advertising is recorded and processed with entries to the Prepaid Advertising, GST Credits and Cash at Bank accounts.

- Debit Prepaid Advertising \$3,600 to increase this asset account.
- Debit GST Credits \$360 to increase this asset account.
- Credit Cash at Bank \$3,960 to decrease this asset account.

Note: The syllabus does not require GST for balance day adjustments. If ignoring GST, the GST Credits entry should not be included. In this instance, the GST Credits entry would not be written and the value of Cash at Bank would match the Prepaid Advertising value of \$3,600.

Date	Details	Debit	Credit
1 Mar 2042	Prepaid Advertising	3,600	
	GST Credits	360	
	Cash at Bank		3,960
	Payment for prepaid advertising		

Prepaid Advertising					
Date	Description	\$	Date	Description	\$
1 Mar 2042	Cash at Bank	3,600			

GST Credits					
Date	Description	\$	Date	Description	\$
1 Mar 2042	Cash at Bank	360			

Cash at Bank					
Date	Description	\$	Date	Description	\$
				Prepaid Advertising / GST Credits	3,960

Step 2 – Calculation of Expense Paid.

The prepaid expense that has been used is an expense and the remaining prepaid expense is an asset. The calculation of the expense used is and closing prepaid expense balance is demonstrated below.

Prepaid Expense Used (expense)						Prepaid Expense Remaining (asset)					
$= 3,600 \times 4/6$						$= 3,600 \times 2/6$					
$= \$2,400$						$= 1,200$					
J	F	M	A	M	J	J	A	S	O	N	D

Balance Day 30 June

Step 3 – Prepaid Expense Adjustment.

The prepaid advertising that has been used during the period is transferred from the prepaid expense account to the expense account.

- Debit Advertising \$2,400 to increase this expense account.
- Credit Prepaid Advertising \$2,400 to decrease this asset account.

The prepaid advertising account is balanced and the closing balance will appear in the balance sheet.

Note: the cash at bank entry in the prepaid expense account represents the original prepayment for advertising.

Note: the difference between the balance day adjustment for prepaid expense and stock of supplies is the name of the current asset account and the name of the expense account. I.e., the stock of supplies current asset account could be "Cleaning Supplies" and the expense account would be "Cleaning Supplies Expense." The other difference is that prepaid expenses are services paid for in advance, whereas stock of supplies are goods (office supplies) paid for in advance.

Date	Details	Debit	Credit
30 Jun 2042	Advertising Prepaid Advertising Prepaid advertising adjustment	2,400	2,400

Advertising (Expense)					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Prepaid Advertising	2,400			

Prepaid Advertising					
Date	Description	\$	Date	Description	\$
1 Mar 2042	Cash at Bank	3,600	30 Jun 2042	Advertising	2,400
			30 Jun 2042	Balance c/d	1,200
		3,600			3,600
1 Jul 2042	Balance b/d	1,200			

Step 4 – Expense to Profit and Loss Account.

The advertising expense is transferred to the profit and loss account.

- Debit Profit and Loss \$2,400 to this working account.
- Credit Advertising \$2,400 to close this expense account.

The Advertising expense of \$2,400 will appear in the Income Statement under Selling and Distribution expenses. The category of the expense created during the prepaid expense adjustment will depend on the specific expense. E.g., telephone expense may instead be categorised as a General and Administrative expenses.

Date	Details	Debit	Credit
30 Jun 2042	Profit and Loss Advertising Expense transferred	2,400	2,400

Profit and Loss					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Advertising	2,400			

Advertising (Expense)					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Prepaid Advertising	2,400	30 Jun 2042	Profit and Loss	2,400
		2,400			2,400

Step 5 – Prepaid expense in the balance sheet.

The prepaid expense remaining appears in the current assets section of the balance sheet with the closing value that was calculated through the balance day adjustment. The total value of this account will appear on the far right column of the balance sheet.

Wheatbelt Farm Supplies Balance Sheet as at 30 June 2042		
Current Assets		
Prepaid Advertising		\$1,200

Practice Questions

Questions 1: Calculation of months to balance day.
 Questions 2-7: Prepaid Expenses and Stock of Supplies general ledger calculations.
 Questions 8-17: Prepaid Expenses and Stock of Supplies.

Tip Practical Summary
 A practical summary for prepaid expenses and stock of supplies has been provided as a reference to support completing initial practice questions.

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.

Prepaid Expenses and Stock of Supplies – 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	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 $Expense\ Paid = C\ Bal + Total\ Expense - O\ Bal$	<table border="1"> <tr> <td colspan="2">Prepaid Expense</td> </tr> <tr> <td>O Bal</td> <td>Total Expense</td> </tr> <tr> <td>Expense paid (CAB)</td> <td>Closing Prepaid</td> </tr> </table>		Prepaid Expense		O Bal	Total Expense	Expense paid (CAB)	Closing Prepaid	Closing Balance • Balance Sheet. Total Expense • Income statement. Expense Paid • Cash budget. • Statement of Cash Flows.
	Prepaid Expense											
O Bal	Total Expense											
Expense paid (CAB)	Closing Prepaid											
Current Asset ↓ Expense												

Note: The 'expense paid' in the 'where adjustment goes' column is not covered until year 12. The expense paid in the prepaid expense ledger can be thought of addition cash paid to increase the amount of an expense that has been prepaid.



Taj Mahal, India.

Question 1

For each of the below tasks, calculate the number of months to balance date and use this information to calculate the closing balance of prepaid expense and how much expense has been used. The first task has been completed as an example.

Required tasks:

a. On 1 April \$3,000 was paid for 4 months advertising. Calculate the value of the prepaid expense account and the expense account at balance day.



Workings

3 months from purchase of prepaid advertising to balance day. 1 month of prepaid advertising remains after balance day.

$$\begin{aligned} \text{Advertising expense} &= 3,000 \times (3/4) \\ &= 2,250 \end{aligned}$$

$$\begin{aligned} \text{Prepaid advertising closing balance} &= 3,000 \times 1/4 \\ &= 750 \end{aligned}$$

$$\begin{aligned} \text{Or Prepaid advertising closing balance} &= 3,000 - 2,250 \\ &= 750 \end{aligned}$$

Therefore, the prepaid advertising closing balance is \$750 and the advertising expense for the period is \$2,250.

b. Prepaid insurance for 12 months was purchased on 30 September for \$5,400. Calculate the value of the prepaid expense account and the expense account at balance day.



Workings

c. The balance of electricity expense was \$600 at balance day. A balance day adjustment is required for the additional cost of prepaid electricity that has been used. \$2,700 was paid for 6 months of prepaid electricity on 1 May. Calculate the value of the prepaid expense account and the expense account at balance day.

J	F	M	A	M	J	J	A	S	O	N	D
---	---	---	---	---	---	---	---	---	---	---	---

Balance Day 30 June

Workings

d. The balance of rent expense on the trial balance was \$12,500 at balance day. The trial balance value of prepaid rent was \$3,600. 6 months of rent was prepaid on 31 March. Calculate the value of the prepaid expense account and the expense account at balance day.

J	F	M	A	M	J	J	A	S	O	N	D
---	---	---	---	---	---	---	---	---	---	---	---

Balance Day 30 June

Workings

e. The trial balance value of prepaid telephone was \$7,200. 8 months of telephone was prepaid on 1 February. Calculate the value of the prepaid expense account and the expense account at balance day.

J	F	M	A	M	J	J	A	S	O	N	D
---	---	---	---	---	---	---	---	---	---	---	---

Balance Day 30 June

Workings

f. The trial balance value of prepaid rent was \$28,800. 12 months of rent was prepaid on 31 October. Calculate the value of the prepaid expense account and the expense account at balance day.

J	F	M	A	M	J	J	A	S	O	N	D
---	---	---	---	---	---	---	---	---	---	---	---

Balance Day 30 June

Workings

Practice Questions

Questions 2-7: Prepaid Expenses and Stock of Supplies general ledger calculations.

Question 2

A business has provided the following information:

- Prepaid Rent opening balance: \$5,000.
- Prepaid Rent closing balance: \$3,000.

Required tasks:

a. Use the information provided to complete the ledger account below.

Prepaid Rent					
Date	Description	\$	Date	Description	\$
	Balance	5,000		Rent Expense	
				Balance c/d	3,000

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Question 3

A business has provided the following information:

- Prepaid Advertising opening balance: \$7,200.
- Advertising expense for the year: \$2,500.

Required tasks:

a. Use the information provided to complete the ledger account below.

Prepaid Advertising					
Date	Description	\$	Date	Description	\$
	Balance	7,200		Advertising Expense	2,500
				Balance c/d	

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Question 4

A business has provided the following information:

- Prepaid Electricity opening balance: \$1,500.
- Total Electricity expense for the year: \$6,700.
- Additional cash paid for electricity: \$6,300.

Required tasks:

a. Use the information provided to complete the ledger account below.

Prepaid Electricity					
Date	Description	\$	Date	Description	\$
	Balance				
	Cash at Bank				

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the prepaid electricity ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Question 5

A business has provided the following information:

- Cleaning Supplies opening balance: \$900.
- Cleaning Supplies closing balance: \$600.
- Additional cash paid for cleaning supplies: \$200.

Required tasks:

a. Use the information provided to complete the ledger account below.

Cleaning Supplies					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the cleaning supplies ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Question 6

A business has provided the following information:

- Stationery Supplies opening balance: \$2,500.
- Stationery Supplies expense for the period: \$750.

Required tasks:

a. Use the information provided to complete the ledger account below.

Stationery Supplies					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Question 7

A business has provided the following information:

- Stock of Supplies opening balance: \$1,000.
- Stock of Supplies paid for during the period: \$500.
- Stock of Supplies closing balance: \$200.

Required tasks:

a. Use the information provided to complete the ledger account below.

Stock of Supplies					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the stock of supplies ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Practice Questions

Questions 8-17: Prepaid Expenses and Stock of Supplies.

Question 8

Calculate the missing values. The first three have been completed as examples.

	Opening Prepaid Expense	Expense Paid	Total expense	Closing Prepaid Expense
a	15,000	-	12,000	= 15,000 – 12,000 = 3,000
b	6,000	= 4,000 + 3,000 – 6,000 = 1,000	3,000	4,000
c	4,000	2,000	= 4,000 + 2,000 – 1,500 = 4,500	1,500
d	900	-	300	
e	2,500	-	500	
f	500		1,000	2,000
g	1,500		800	3,200
h	900	300		800
i	4,000	1,300		600
j	8,000	-		6,000
k	3,500	-		2,000

GST Credits					
Date	Description	\$	Date	Description	\$

Note: If ignoring GST, the GST Credits account would not be required.

Cash at Bank					
Date	Description	\$	Date	Description	\$

Rent					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

c. Demonstrate prepaid rent on the balance sheet as at 30 June 2037.

Balance Sheet as at 30 June 2037		
Current Assets		
Prepaid Rent		

Question 10

On 23 December 2038, a business paid \$2,200 including GST for cleaning supplies. On balance day \$500 of cleaning supplies remained.

Required task:

a. Prepare the general journal entries to record the initial payment for cleaning supplies and adjust the cleaning supplies account as at 30 June 2039.

Note: the expense account will be cleaning supplies expense.

Workings

Cleaning Supplies Expense					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

c. Demonstrate prepaid rent on the balance sheet as at 30 June 2037.

Balance Sheet as at 30 June 2039		
Current Assets		
Cleaning Supplies		

Question 11

On 1 June 2045, a business paid \$3,300 excluding GST for 3 months of insurance.

Required task:

a. Prepare the general journal entries to adjust the prepaid insurance account as at 30 June 2045.

Workings

Date	Details	Debit	Credit

b. Prepare the general ledger entries to adjust the prepaid insurance account as at 30 June 2045.

Insurance					
Date	Description	\$	Date	Description	\$

Prepaid Insurance					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

c. Demonstrate prepaid insurance on the balance sheet as at 30 June 2045.

Balance Sheet as at 30 June 2045		
Current Assets		
Prepaid insurance		

Question 12

Describe the nature of prepaid expenses. In your response, discuss how prepaid expenses meets the relevant conceptual framework definition.

Question 13

Describe the purpose of the prepaid expenses balance day adjustment. In your response, describe the effect on the balance sheet and income statement if the prepaid expenses adjustment was not carried out.

Question 14

Describe the effect on the balance sheet and income statement of carrying out the prepaid expense adjustment.

Question 15

List the account created when carrying out the prepaid expense adjustment and the recognition criteria that creates this account.

Question 16

Trial balance (extract) As at 30 June 2050		
	Debit \$	Credit \$
Prepaid Rent	9,000	
Prepaid Advertising	1,000	

Additional information:

- Prepaid rent at 30 June 2049 was 14,500.
- Advertising paid during the year ended 30 June 2050 was \$3,000.

Required tasks:

- Calculate the rent expense.
- Calculate the advertising expense.

Workings

Question 17

Trial balance (extract) As at 30 June 2050		
	Debit \$	Credit \$
Advertising	5,000	
Prepaid insurance	1,000	

Additional information:

- Prepaid advertising on 30 June 2050 was \$500.
- Insurance paid during the year ended 30 June 2050 was 4,700.

Required tasks:

- Calculate the advertising expense.
- Calculate the insurance expense.

Workings

Accrued Expenses

Accrued expenses are expenses that have occurred during an accounting period but have not yet been paid at balance day. Most expenses are usually only recorded as they are paid, therefore, expenses that have been used but not paid require balance day adjustments to correctly record the expense used and the expense owing (accrued expense) at balance day. The accrued expense that is recorded at balance day is paid in the following accounting period. Examples of accrued expenses include accrued wages, accrued telephone expense, accrued interest on loan, accrued rent etc.

Accrued Expenses – Nature and Purpose

Theory		Accrued expense
Nature	Conceptual Framework category of original account	Current Liability.
	How this account meets the conceptual framework definition?	<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>
Accounts Created	Accounts created	Expense.
	Recognition process that creates the account	Recognition of current liability.
Purpose (of the adjusting entry)	Purpose overview	To record expenses incurred but not yet paid as at balance date.
	Effect on Balance Sheet	<ul style="list-style-type: none"> • Current liabilities increased.
	Effect on Income Statement	<ul style="list-style-type: none"> • Expenses increased. • Profit decreased.
	Effect on balance sheet if not accounted for	<ul style="list-style-type: none"> • Current liabilities understated.
	Effect on income statement if not adjusted on balance day	<ul style="list-style-type: none"> • Expenses understated. • Profit overstated.

Example

The following information has been provided by Wheatbelt Farm Supplies.

- Wages paid from 1 July 2041 to 23 June 2042 was \$15,300.
- Wages of \$1,200 are paid every four weeks.
- On 30 June 2042, one week of wages had not yet been paid.
- On 21 July 2042, wages of \$1,200 were paid, including the accrued wages from the previous period.

Required task:

- a. Prepare the general journal and general ledger entries to adjust the accrued wages account as at 30 June 2042.
- b. Demonstrate accrued wages on the balance sheet as at 30 June 2042.
- c. Record the payment of the accrued wages in the following account period.

Solution

Step 1 – Calculation of Accrued Expense (Expense Owing).

Wages of \$1,200 are every four weeks and one week has not been paid as at balance day.

$$\begin{aligned}\text{Accrued wages} &= 1,200 \times 1/4 \\ &= \$300\end{aligned}$$

Therefore, the accrued wages at balance day are \$300.

Step 2 – Accrued Expense Adjustment.

The accrued expense adjustment is recorded in the accrued expense and expense account.

- Debit Wages \$300 to increase this expense account.
- Credit Accrued Wages \$300 to increase this liability account.

Note: the entry that is not bolded in the wages account represents the most recent balance of wages expense paid prior to balance day.

Date	Details	Debit	Credit
30 Jun 2042	Wages	300	
	Accrued Wages		300
	Accrued wages adjustment		

Wages					
Date	Description	\$	Date	Description	\$
23 Jun 2042	Balance	15,300			
30 Jun 2042	Accrued Wages	300			

Accrued Wages (Liability)					
Date	Description	\$	Date	Description	\$
			30 Jun 2042	Wages	300

Step 3 – Expense to Profit and Loss Account.

The wages expense is transferred to the profit and loss account.

- Debit Profit and Loss \$15,600 to this working account.
- Credit Wages \$15,600 to close this expense account.

This figure is \$15,600 because the accrued wages is added to the prior wages expense from the period. The Wages expense of \$15,600 will appear in the income statement within either Selling and Distribution expense or General and Administrative expenses depending on whether the wages are for sales staff or office staff. For other types of accrued expense, the expense account created will usually be categorised as either Selling and Distribution expenses and General and Administrative expenses.

Date	Details	Debit	Credit
30 Jun 2042	Profit and Loss	15,600	
	Wages		15,600
	Expense transferred		

Profit and Loss					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Wages	15,600			

Wages					
Date	Description	\$	Date	Description	\$
23 Jun 2042	Balance	15,300	30 Jun 2042	Profit and Loss	15,600
30 Jun 2042	Accrued Wages	300			
		15,600			15,600

Step 4 – Accrued Expense in the Balance Sheet.

The accrued expense (expense owing) appears in the current liabilities section of the balance sheet with the closing value that was calculated through the balance day adjustment.

Wheatbelt Farm Supplies Balance Sheet as at 30 June 2042		
Current Liabilities		
Accrued wages		\$300

Step 5 – Payment of Accrued Expense in the next accounting period.

The payment of the accrued wages from the previous period and the first payment for wages of the following period are recorded with entries to the accrued wages, wages and cash at bank account.

- Debit Accrued Wages \$300 to decrease this liability account.
- Debit Wages \$900 to increase this expense account.
- Credit Cash at Bank \$1,200 to decrease this asset account.

Note: the entry in the accrued wages account that is not bolded is from the balance day adjustment at the end of the previous period.

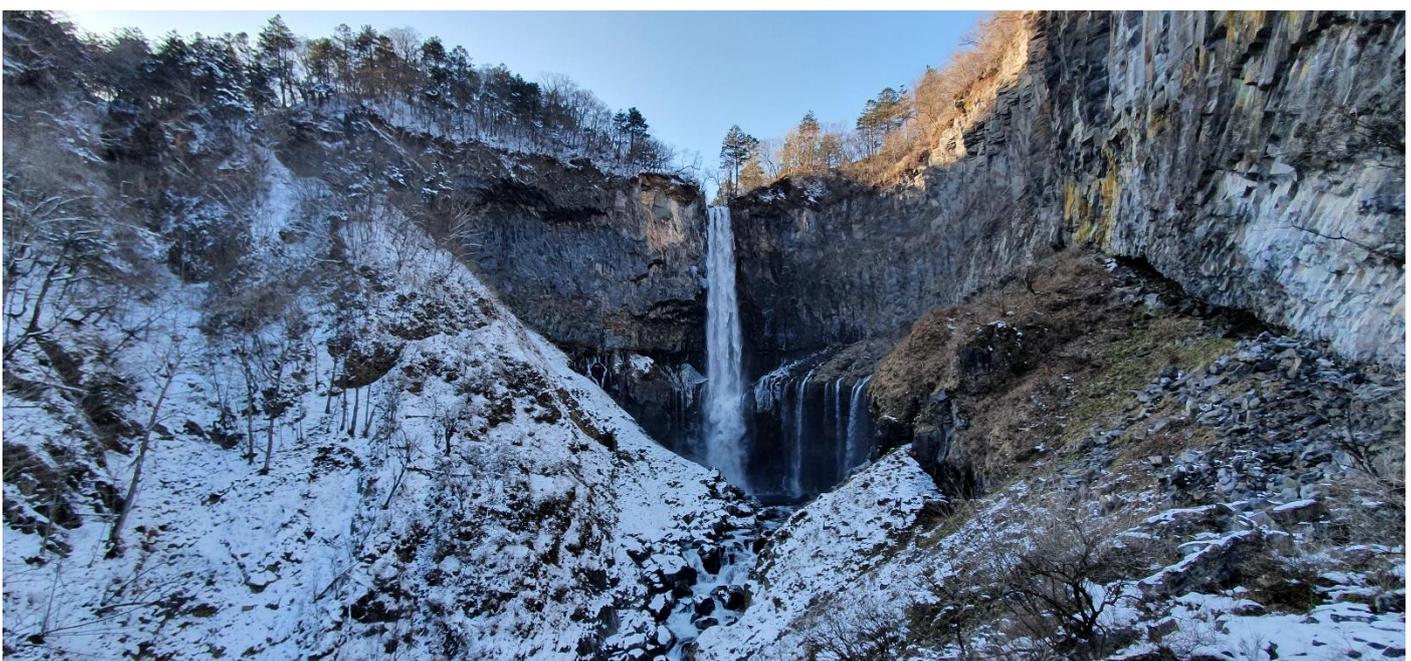
Note: If the accrued expense attracts GST, then GST credits will be a separate entry that is debited and the value is added to the cash at bank credit entry. GST are not relevant to the year 11 balance day adjustment syllabus.

Date	Details	Debit	Credit
21 Jul 2042	Accrued Wages	300	
	Wages	900	
	Cash at Bank		1,200
	Wages payment		

Accrued Wages (Liability)					
Date	Description	\$	Date	Description	\$
21 Jul 2042	Cash at Bank	300	30 Jun 2042	Wages	300

Wages					
Date	Description	\$	Date	Description	\$
21 Jul 2042	Cash at Bank	900			

Cash at Bank					
Date	Description	\$	Date	Description	\$
			21 Jul 2042	Accrued Wages / Wages	1,200



Kegon Falls, Nikko.

Practice Questions

Questions 18-23: Accrued Expenses general ledger calculations.

Questions 24-35: Accrued Expenses.

Tip Practical Summary

A practical summary for accrued expenses has been provided as a reference to support completing initial practice questions.

Accrued Expenses – Practical Summary

Adjustment	Account to adjust	What to do	Workings	Account	Where adjustment goes							
Accrued Expense	Expense Account	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	<table border="1"> <tr> <td colspan="2">Accrued Expense</td> </tr> <tr> <td>Expense Paid (CAB)</td> <td>O Bal</td> </tr> <tr> <td>C Bal</td> <td>Total Expense</td> </tr> </table>		Accrued Expense		Expense Paid (CAB)	O Bal	C Bal	Total Expense	Closing Balance • Balance Sheet. Total Expense: • Income statement. Expense Paid: • Cash budget • Statement of Cash Flows
	Accrued Expense											
Expense Paid (CAB)	O Bal											
C Bal	Total Expense											
Current Liability ↓ Expense												

Note: The 'expense paid' in the 'where adjustment goes' column is not covered until year 12.

Question 18

A business has provided the following information:

- Wages expense at balance day: \$9,500.
- Wages used but not yet paid for: \$1,200.

Required tasks:

a. Use the information provided to complete the ledger accounts below.

Accrued Wages					
Date	Description	\$	Date	Description	\$
	Balance c/d			Wages Expense	

Wages Expense					
Date	Description	\$	Date	Description	\$
	Balance			Profit and Loss	
	Accrued Wages				

b. What is the value that will appear on the income statement?

Workings

c. What is the value that will appear on the balance sheet?

Question 19

A business has provided the following information:

- Internet expense at balance day: \$12,000.
- Internet owing at balance day to be adjusted: \$600.

Required tasks:

a. Use the information provided to complete the ledger accounts below.

Accrued Internet					
Date	Description	\$	Date	Description	\$
	Balance c/d			Internet Expense	

Internet Expense					
Date	Description	\$	Date	Description	\$
	Balance	12,000		Profit and Loss	
	Accrued Internet				

b. What is the value that will appear on the income statement?

Workings

c. What is the value that will appear on the balance sheet?

Question 20

A business has provided the following information:

- Wages Expense at balance day: \$17,300.
- Opening Accrued Wages: \$1,400.
- Cash paid for Accrued Wages during the period: \$1,400.
- Closing Accrued Wages at balance day: \$900.

Required tasks:

a. Use the information provided to complete the ledger accounts below.

Accrued Wages					
Date	Description	\$	Date	Description	\$

Wages Expense					
Date	Description	\$	Date	Description	\$
	Balance	17,300		Profit and Loss	
	Accrued Wages				

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the accrued wages ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Question 21

A business has provided the following information:

- Electricity Expense at balance day: \$5,100.
- Opening Accrued Electricity: \$1,900.
- Cash paid for Accrued Electricity during the period: \$1,600.
- Closing Accrued Electricity at balance day: \$500.

Required tasks:

a. Use the information provided to complete the ledger accounts below.

Accrued Electricity					
Date	Description	\$	Date	Description	\$

Electricity Expense					
Date	Description	\$	Date	Description	\$
		5,100			

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the accrued wages ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Question 22

A business has provided the following information:

- Rent Expense at balance day: \$12,500.
- Opening Accrued Rent: \$700.
- Closing Accrued Rent at balance day: \$900.
- Cash paid for Accrued Rent during the period: \$300.

Required tasks:

a. Use the information provided to complete the ledger accounts below.

Accrued Rent					
Date	Description	\$	Date	Description	\$

Rent Expense					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the accrued rent ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Question 23

A business has provided the following information:

- Interest Expense at balance day: \$1,100.
- Closing Accrued Interest Expense at balance day: \$250.
- Opening Accrued Interest Expense: \$150.

Required tasks:

a. Use the information provided to complete the ledger accounts below.

Accrued Interest Expense					
Date	Description	\$	Date	Description	\$

Interest Expense					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Practice Questions

Questions 24-35: Accrued Expenses.

Question 24

Calculate the missing figures in the table.

	Opening Accrued Income	Total Income	Income Received	Closing Accrued Income
a	-	$500 + 700 = 1,200$	500	700
b	600	$1,200 + 900 - 600 = 1,500$	1,200	900
c	-	2,300	$2,300 - 1,300 = 1,000$	1,300
d	900	800	$900 + 800 - 1,200 = 500$	1,200
e	-		1,500	1,200
f	-		250	730
g	500		100	900
h	1,200		900	600
i	-	1,800		1,200
j	-	1,550		880
k	3,100	1,900		400
l	2,500	2,800		2,100

Question 25

Calculate the missing figures in the table.

	Opening Accrued Expense	Expense Paid	Total Expense	Closing Accrued Expense
a	-	1,200	2,500	= Total Expense – Expense Paid = 2,500 – 1,200 = \$1,300
b	-	= 6,000 – 1,000 = \$5,000	6,000	1,000
c	1,300	-	= 2,000 - 1,300 = 700	2,000
d	-	1,000	= 1,000 + 3,000 = \$4,000	3,000
e	2,500	= 2,500 + 1,000 – 500 = \$3,000	1,000	500
f	-	8,000	9,000	
g	-	1,200	3,500	
h	-		3,000	1,500
i	-		4,200	1,600
j	1,400	-		4,000
k	3,000	-		8,000
l	-	800		900
m	-	1,200		800
n	600		200	100
o	1,800		900	1,500

Question 26

The following information has been provided by a business.

- Wages paid from 1 July 2035 to 23 June 2036 was \$20,000.
- Wages of \$800 are paid every fortnight.
- On 30 June 2036, one week of wages had not yet been paid.
- On 7 July 2036, wages of \$800 were paid, including the accrued wages from the previous period.

Required tasks:

a. Prepare the general journal entries to adjust the accrued expense account as at 30 June 2036 and record the payment of the accrued expense in the following period.

Workings

Date	Details	Debit	Credit

b. Prepare the general ledger entries to adjust the accrued expense account as at 30 June 2036 and record the payment of the accrued expense in the following period.

Wages					
Date	Description	\$	Date	Description	\$

Accrued Wages					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Cash at Bank					
Date	Description	\$	Date	Description	\$

c. Demonstrate the accrued expense in the balance sheet as at 30 June 2036.

Balance Sheet as at 30 June 2036		
Current Liabilities		
Accrued Wages		

Question 27

A business pays a telephone bill of \$300 plus GST every three months. This telephone bill is not paid in advance.

The most recent telephone bill was paid on 1 June 2031 which brought the total telephone expense to \$900.

Required tasks

a. Prepare the general journal entries and to record the accrued telephone expense at 30 June 2031 and the payment of the accrued telephone expense in the next accounting period.

Workings

Date	Details	Debit	Credit

b. Prepare the general ledger entries and to record the accrued telephone expense at 30 June 2031 and the payment of the accrued telephone expense in the next accounting period.

Telephone expense					
Date	Description	\$	Date	Description	\$

Accrued Telephone Expense					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

GST Credits					
Date	Description	\$	Date	Description	\$

Note: If ignoring GST, the GST Credits account would not be required.

Cash at Bank					
Date	Description	\$	Date	Description	\$

Accrued Internet					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

GST Credits					
Date	Description	\$	Date	Description	\$

Note: If ignoring GST, the GST Credits account would not be required.

Cash at Bank					
Date	Description	\$	Date	Description	\$

c. Demonstrate the accrued expense in the balance sheet as at 30 June 2030.

Balance Sheet as at 30 June 2030		
Current Liabilities		
Accrued Internet		

Question 29

From 1 July 2042 to 30 April 2043, the business has paid \$5,400 + \$540 GST for electricity. The business will receive and pay its electricity bill for 1 May 2043 to 1 September 2043 on 1 September 2043.

Required tasks:

a. Prepare the general journal entries to adjust the accrued expense account as at 30 June 2043 and record the payment of the accrued expense in the following period.

Workings

c. Demonstrate the accrued expense in the balance sheet as at 30 June 2043.

Balance Sheet as at 30 June 2043		
Current Liabilities		
Accrued Electricity		

Question 30

Describe nature of accrued expenses. In your response, discuss how accrued expenses meets the relevant conceptual framework definition.

Question 31

Describe the purpose of the accrued expenses balance day adjustment. In your response, describe the effect on the balance sheet and income statement if the accrued expenses adjustment was not carried out.

Question 32

Describe the effect on the balance sheet and income statement of carrying out the accrued expenses adjustment.

Question 33

List the account created when carrying out the accrued expenses adjustment and the recognition criteria that creates this account.

Question 34

Balance Sheet (extract) As at 30 June 2050		
	30 June 2049	30 June 2050
Accrued wages	10,000	15,000
Accrued selling and distribution expense	5,000	4,000

Additional information

- The wages expense paid during the year ended 30 June 2050 was \$12,000.
- The selling and distribution expense paid during the year ended 30 June 2050 was \$7,000.

Required tasks:

- Calculate the wages expense.
- Calculate the selling and distribution expense.

Workings

Question 35

Trial balance (extract) As at 30 June 2050		
	Debit \$	Credit \$
Wages	10,000	
Accrued wages		5,000
Interest expense	3,000	
Accrued interest expense		1,500

Additional information:

- At 30 June 2049, accrued wages was \$4,000 and accrued interest was \$1,000.

Required tasks:

- Calculate the wages expense.
- Calculate the interest expense.

Workings

Unearned Income

If a business receives payment in advance and has not yet provided the service or good that the customer has paid for, this represents income that has not yet been earned. A balance day adjustment takes place to record the amount of income that has been received as income and the amount not yet received as a liability.

Unearned Income – Nature and Purpose

Theory		Unearned Income / Income Received in Advance
Nature	Conceptual Framework category of original account	Current Liability.
	How this account meets the conceptual framework definition?	<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>
Accounts Created	Accounts created	Income.
	Recognition process that creates the account	Derecognition of current liability.
Purpose (of the adjusting entry)	Purpose overview	To record income earned at balance date.
	Effect on Balance Sheet	<ul style="list-style-type: none"> • Current liabilities decreased.
	Effect on Income Statement	<ul style="list-style-type: none"> • Income increased. • Profit increased.
	Effect on balance sheet if not accounted for	<ul style="list-style-type: none"> • Current liabilities overstated.
	Effect on income statement if not adjusted on balance day	<ul style="list-style-type: none"> • Income understated. • Profits understated.

Example

Fresh Sheets washes sheets for large hotel chains and had provided the following information.

- On 12 April 2045, Clean Sheets received income in advance of \$14,000 GST exclusive.
- On 30 June 2045, \$9,000 of cleaning services had been provided to the customer who paid in advance.

Required task:

- Prepare the general journal and general ledger entries to adjust the unearned income account as at 30 June 2045.
- Demonstrate unearned income on the balance sheet as at 30 June 2045.

Solution

Step 1 – Cash received for unearned income.

When the cash is first received for the unearned income, this is recorded and processed in the Cash at Bank, GST Payable and Unearned Income accounts.

- Debit Cash at Bank \$15,400 to increase this asset account.
- Credit GST Payable \$1,400 to increase this liability account.
- Credit Unearned income \$14,000 to increase this liability account.

Note: The syllabus does not require GST for balance day adjustments. GST has been included here for real world extension. Your balance day adjustment assessments should not require you to complete balance day adjustments with GST. If ignoring GST, the GST Payable account would not be present and the Cash at Bank figure would match the Unearned income figure of \$14,000.

Date	Details	Debit	Credit
12 Apr 2045	Cash at Bank	15,400	
	GST Payable		1,400
	Unearned Income		14,000
	Unearned income received		

Cash at Bank					
Date	Description	\$	Date	Description	\$
12 Apr 2045	Unearned Income / GST Payable	15,400			

GST Payable					
Date	Description	\$	Date	Description	\$
12 Apr 2045	Cash at Bank				1,400

Unearned Income					
Date	Description	\$	Date	Description	\$
12 Apr 2045	Cash at Bank				14,000

Step 2 – Unearned Income Adjustment.

This adjustment decreases the unearned income by the amount that has been earned. The amount that has been earned is recorded as an increase to the fees income account.

- Debit Unearned Income \$9,000 to decrease this liability account.
- Credit Fees \$9,000 to increase this income account.

Note: the cash at bank entry in the unearned income account represents the original amount received prior to providing the service.

The Unearned Income is balanced to record the total unearned income liability at balance day. This will appear in the balance sheet.

Date	Details	Debit	Credit
30 Jun 2045	Unearned Income	9,000	
	Fees		9,000
	Unearned income adjustment		

Unearned Income					
Date	Description	\$	Date	Description	\$
30 Jun 2045	Fees	9,000	12 Apr 2045	Cash at Bank	14,000
30 Jun 2045	Balance c/d	5,000			
		14,000			14,000
			1 Jul 2045	Balance b/d	5,000

Fees					
Date	Description	\$	Date	Description	\$
30 Jun 2045	Unearned Income				9,000

Step 3 – Income to Profit and Loss Account.

The fees income is transferred to the profit and loss account.

- Debit Fees \$9,000 to close this income account.
- Credit Profit and Loss \$9,000 to this working account.

The Fees income of \$9,000 will appear in the income statement.

Date	Details	Debit	Credit
30 Jun 2045	Fees	9,000	
	Profit and Loss		9,000
	Income transferred		

Fees					
Date	Description	\$	Date	Description	\$
30 Jun 2045	Profit and Loss	9,000	30 Jun 2045	Unearned Income	9,000
		9,000			9,000

Profit and Loss					
Date	Description	\$	Date	Description	\$
			30 Jun 2045	Fees	9,000

Step 4 – Unearned Income in the Balance Sheet.

The unearned income (income received but not earned) appears in the current liabilities section of the balance sheet with the closing value that was calculated through the balance day adjustment.

Fresh Sheets Balance Sheet as at 30 June 2045		
Current Liabilities		
Unearned Income		\$5,000

Practice Questions

Questions 36-41: Unearned Income general ledger calculations.

Questions 42-51: Unearned Income.

Tip Practical Summary

A practical summary for unearned income has been provided as a reference to support completing initial practice questions.

Unearned Income – Practical Summary

Adjustment	Account to adjust	What to do	Workings	Account	Where adjustment goes							
Unearned Income / Income Received in Advance	Income Received in Advance	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 $Income\ Received = C\ Bal + Total\ Income - O\ Bal$	<table border="1"> <thead> <tr> <th colspan="2">Unearned Income</th> </tr> </thead> <tbody> <tr> <td>Total Income</td> <td>O Bal</td> </tr> <tr> <td>C Bal</td> <td>Income Received (CAB)</td> </tr> </tbody> </table>		Unearned Income		Total Income	O Bal	C Bal	Income Received (CAB)	Closing Balance • Balance Sheet. Total Income • Income statement Income Received: • Cash budget • Statement of Cash Flows
	Unearned Income											
Total Income	O Bal											
C Bal	Income Received (CAB)											
Current Liability ↓ Income												

Note: The 'income received' in the 'where adjustment goes' column is not covered until year 12.

Question 36

A business has provided the following information:

- Unearned Income opening balance: \$6,000.
- Unearned Income closing balance: \$2,000.

Required tasks:

a. Use the information provided to complete the ledger account below.

Unearned Income					
Date	Description	\$	Date	Description	\$
	Fees Income			Balance	
	Balance c/d				

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Question 37

A business has provided the following information:

- Unearned Income opening balance: \$12,000.
- Further cash received in advance during the period: \$2,000.
- Unearned Income closing balance: \$5,000.

Required tasks:

a. Use the information provided to complete the ledger account below.

Unearned Income					
Date	Description	\$	Date	Description	\$
	Fees Income			Balance	
	Balance c/d			Cash at Bank	

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the unearned income ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Question 38

A business has provided the following information:

- Opening balance of income received in advance: \$21,000.
- Fees income earned during the period \$3,500.

Required tasks:

a. Use the information provided to complete the ledger account below.

Income Received in Advance					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Question 39

A business has provided the following information:

- Opening balance of income received in advance: \$18,200.
- Cash received in advance for services during the period: \$1,700.
- Fees income earned during the period: \$15,200.

Required tasks:

a. Use the information provided to complete the ledger account below.

Income Received in Advance					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the Income Received in Advance ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Question 40

A business has provided the following information:

- Cash received for unearned income during the period: \$45,200.
- Fees income account balance at balance day: \$27,000.
- Fees income earned during the period: \$12,700.

Required tasks:

a. Use the information provided to complete the ledger account below.

Unearned Income					
Date	Description	\$	Date	Description	\$
	Fees Income			Cash at Bank	
	Balance c/d				

Fees Income					
Date	Description	\$	Date	Description	\$
	Profit and Loss			Balance	
				Unearned Income	

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the Unearned Income ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Question 41

A business has provided the following information:

- Opening balance of Income Received in Advance: \$88,800.
- Closing balance of Income Received in Advance: \$9,900.
- Cash received for income received in advance during the period: \$3,300.
- Fees income account balance at balance day: \$22,200.

Required tasks:

a. Use the information provided to complete the ledger account below.

Income Received in Advance					
Date	Description	\$	Date	Description	\$

Fees Income					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the Income Received in Advance ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Practice Questions

Questions 42-51: Unearned Income.

Question 42

Calculate the missing figures in the table below.

	Opening Unearned Income	Income Received	Total Income	Closing Unearned Income
a	12,000	-	= 12,000 – 5000 = \$7,000	5,000
b	580	120	= 580 + 120 – 200 = \$500	200
c	450	= 300 + 200 – 450 = \$50	200	300
d	3,000	-	1,800	= 3,000 – 1,800 = \$1,200
e	6,000	-		3,000
f	1,800	-		1,200
g	500	200		150
h	1,500	600		1,800
i	600		300	400
j	650		250	600
k	900	-	500	
l	1,500	-	1,000	

Question 43

On 31 January 2030, a dance studio received \$10,000 GST exclusive for 8 months of lessons that will take place in the future.

Required task:

a. Prepare the general journal entries to record the initial transaction and adjust the unearned income account as at 30 June 2030.

Note: fees earned can be calculated as the unearned income multiplied by the portion of months elapsed.

Workings

b. Prepare the general ledger entries to record the initial transaction and adjust the unearned income account as at 30 June 2038.

Cash at Bank					
Date	Description	\$	Date	Description	\$

GST Payable					
Date	Description	\$	Date	Description	\$

Note: If ignoring GST, the GST Payable account would not be required.

Unearned Income					
Date	Description	\$	Date	Description	\$

Fees					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

c. Demonstrate unearned income on the balance sheet as at 30 June 2038.

Balance Sheet as at 30 June 2038		
Current Liabilities		
Unearned Income		

Question 45

On 15 January 2045, a school received \$19,800 GST inclusive in fees. On balance day \$12,000 of fees had been earned.

Required tasks:

a. Prepare the general journal entries to adjust the unearned income account as at 30 June 2045.

Date	Details	Debit	Credit

b. Prepare the general ledger entries to adjust the unearned income account as at 30 June 2045.

Unearned Income					
Date	Description	\$	Date	Description	\$

Fees					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

c. Demonstrate unearned income on the balance sheet as at 30 June 2045.

Balance Sheet as at 30 June 2038		
Current Liabilities		
Unearned Income		

Question 46

Describe nature of unearned income. In your response, discuss how unearned income meets the relevant conceptual framework definition.

Question 47

Describe the purpose of the unearned income balance day adjustment. In your response, describe the effect on the balance sheet and income statement if the unearned income adjustment was not carried out.

Question 48

Describe the effect on the balance sheet and income statement of carrying out the unearned income adjustment.

Question 49

List the account created when carrying out the unearned income adjustment and the recognition criteria that creates this account.

Question 50

Trial balance (extract) As at 30 June 2050		
	Debit \$	Credit \$
Unearned Fees Income		40,000

Additional information

- Unearned Fees Income on 30 June 2050 was \$6,200.

Required task:

- Calculated the fees income.
- State the unearned income value shown on the balance sheet within the liabilities section.

Workings

Question 51

Trial balance (extract) As at 30 June 2050		
	Debit \$	Credit \$
Unearned Fees Income		70,000

Additional information

- Unearned fees income on 30 June 2050 was \$8,900.
- Fees Income received was \$6,700.

Required task:

- Calculated the fees income.
- State the unearned income value shown on the balance sheet within the liabilities section.

Workings

Accrued Income

Accrued income is income that has been earned during a period but not yet received by balance day. A balance day adjustment is required to increase the income account according to how much income has been earned but not yet received. The accrued income (asset) account also increases.

Accrued Income – Nature and Purpose

Theory		Accrued income (Income earned but not received)
Nature	Conceptual Framework category of original account	Current Asset.
	How this account meets the conceptual framework definition?	<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>
Accounts Created	Accounts created	Income.
	Recognition process that creates the account	Recognition of the current asset.
Purpose (of the adjusting entry)	Purpose overview	To record income earned but not yet received at balance date.
	Effect on Balance Sheet	<ul style="list-style-type: none"> • Current assets increased.
	Effect on Income Statement	<ul style="list-style-type: none"> • Income increased. • Profit increased.
	Effect on balance sheet if not accounted for	<ul style="list-style-type: none"> • Current assets understated.
	Effect on income statement if not adjusted on balance day	<ul style="list-style-type: none"> • Income understated. • Profit understated.



Stonehenge, England.

Example

Wheatbelt Farm Supplies has provided the following information.

- On 1 May 2042, the business made a \$30,000, 6 month term deposit which earned 5% interest per annum.

Required task:

- Prepare the general journal and general ledger entries to adjust the accrued interest income account as at 30 June 2042.
- Demonstrate accrued interest income on the balance sheet as at 30 June 2042.
- Record the interest income received during the following account period.

Solution

Step 1 – Calculation of Accrued Income.

At the end of a term deposit a business receives the initial amount deposited (principal) plus interest. This interest is income.

The interest income has been earned for the period before balance day but is not received until 6 months after the term deposit was made. The accrued interest income is demonstrated and calculated below.

Accrued Interest = $750 \times (2/6)$ = \$250						Interest received on 1 Nov 2042 \$750					
J	F	M	A	M	J	J	A	S	O	N	D

Balance Day 30 June

$$\text{Interest received at end of investment} = \text{Deposit} \times \left(\frac{\text{Interest Rate per year}}{12} \times \frac{\text{Period of Investment}}{12} \right)$$

$$\text{Income received at end of term deposit (1 Nov 2042)} = 30,000 \times [0.05 \times (6/12)] = \$750$$

Note: The interest rate is multiplied by 6/12 because the interest rate is per annum (per 12 months) and the term deposit is only made for 6 months.

$$\text{Accrued Interest Income} = \text{Income received at end of term deposit} \times \frac{\text{Elapsed Investment Period}}{\text{Total Investment period}}$$

$$\text{Accrued Interest Income} = 750 \times (2/6) = \$250$$

Step 2 – Accrued Income Adjustment.

The accrued interest income adjustment increases both the accrued interest and interest income account.

- Debit Accrued Interest \$250 to increase this asset account.
- Credit Interest Income \$250 to increase the income account.

The Interest Income of \$250 will appear in the income statement within ‘Add Other Income’.

Date	Details	Debit	Credit
30 Jun 2042	Accrued Interest Income Interest Income Accrued income adjustment	250	250

Accrued Interest Income					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Interest Income	250			

Interest Income					
Date	Description	\$	Date	Description	\$
			30 Jun 2042	Accrued Interest Income	250

Step 3 – Income to Profit and Loss Account.

The accrued interest income is transferred to the profit and loss account.

- Debit Interest Income \$250 to close this income account.
- Credit Profit and Loss \$250 to this working account.

Date	Details	Debit	Credit
30 Jun 2042	Interest Income Profit and Loss Income transferred	250	250

Interest Income					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Profit and Loss	250	30 Jun 2042	Accrued Interest Income	250
		250			250

Profit and Loss					
Date	Description	\$	Date	Description	\$
			30 Jun 2042	Interest Income	250

Step 4 – Accrued Income in the Balance Sheet.

The accrued income (income earned but not yet received) appears in the current assets section of the balance sheet with the closing value that was calculated through the balance day adjustment.

Wheatbelt Farm Supplies Balance Sheet as at 30 June 2042		
Current Assets		
Accrued Interest Income		\$250

Step 5 – Accrued Income Received in the Next Accounting Period.

The interest income is transferred to the profit and loss account.

- Debit Cash at Bank \$750 to increase this asset account.
- Debit Accrued Interest Income \$250 to decrease this asset account.
- Credit Profit and Loss \$500 to this income account.

The \$500 entry to interest income can be calculated in a few different ways.

The cash at bank figured can be subtracted by the accrued interest income figure i.e., 750 – 250 = 500.

Alternatively, the below formula could be used.

$$\text{Interest Income} = \text{Income received at end of term deposit} \times \frac{\text{Investment Period after balance day}}{\text{Total Investment period}}$$

Interest income = 750 x 4/6 = 500.

Date	Details	Debit	Credit
1 Nov 2042	Cash at Bank	750	
	Accrued Interest Income		250
	Interest Income		500
	Interest income received		

Cash at Bank					
Date	Description	\$	Date	Description	\$
1 Nov 2042	Interest Income / Accrued Interest Income	750			

Accrued Interest Income					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Interest Income	250	1 Nov 2042	Cash at Bank	250

Interest Income					
Date	Description	\$	Date	Description	\$
			1 Nov 2042	Cash at Bank	500



View from Zell am See Gondola looking over Kaprun and Kitzsteinhorn, Austria.

Practice Questions

Questions 52-57: Accrued Income general ledger calculations.

Questions 58-68: Accrued Income.

Tip Practical Summary

A practical summary for accrued income has been provided as a reference to support completing initial practice questions.

Accrued Income – Practical Summary

Adjustment	Account to adjust	What to do	Workings	Account	Where adjustment goes							
Accrued Income	Income Account	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	<table border="1"> <tr> <td colspan="2">Accrued Income</td> </tr> <tr> <td>O Bal</td> <td>Income Received (CAB)</td> </tr> <tr> <td>Total Income</td> <td>C Bal</td> </tr> </table>		Accrued Income		O Bal	Income Received (CAB)	Total Income	C Bal	Closing Balance • Balance Sheet. Total Income: • Income Statement. Income Received: • Cash budget. • Statement of Cash Flows.
	Accrued Income											
O Bal	Income Received (CAB)											
Total Income	C Bal											
Current Asset ↓ Income												

Note: The 'income received' in the 'where adjustment goes' column is not covered until year 12.

Question 52

A business has provided the following information:

- Interest income earned but not yet received at balance day: \$400.

Required tasks:

a. Use the information provided to complete the ledger account below.

Accrued Interest Income					
Date	Description	\$	Date	Description	\$
	Interest Income			Balance c/d	

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Question 53

A business has provided the following information:

- Opening Accrued Interest Income: \$200.
- Closing Interest income earned but not yet received at balance day: \$500.
- Interest Income balance at balance day: \$700.

Required tasks:

a. Use the information provided to complete the ledger account below.

Accrued Interest Income					
Date	Description	\$	Date	Description	\$
	Balance			Balance c/d	
	Interest Income				

Interest Income					
Date	Description	\$	Date	Description	\$
	Profit and Loss			Cash at Bank	
				Accrued Interest Income	

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Question 54

A business has provided the following information:

- Opening Accrued Income: \$250.
- Cash received for interest income earned during the previous period: \$250.
- Interest Income earned during the period but not yet received: \$500.

Required tasks:

a. Use the information provided to complete the ledger account below.

Accrued Interest Income					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the Accrued Interest Income ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Question 55

A business has provided the following information:

- Closing balance of Accrued Interest Income: \$700.
- Opening balance of Accrued Interest Income: \$200.
- No cash was received for accrued interest income from the previous period during this current accounting period.

Required tasks:

a. Use the information provided to complete the ledger account below.

Accrued Interest Income					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Question 56

A business has provided the following information:

- Closing balance of Accrued Interest Income: \$1,800.
- Opening balance of Accrued Interest Income: \$900.
- Interest Income at balance day: \$1,900.
- No cash was received for accrued interest income from the previous period during this current accounting period.

Required tasks:

a. Use the information provided to complete the ledger account below.

Accrued Interest Income					
Date	Description	\$	Date	Description	\$

Interest Income					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Question 57

A business has provided the following information:

- Accrued Interest Income opening balance: \$2,700.
- Accrued Interest Income closing balance: \$3,000.
- Cash received for Accrued Interest Income during the period: \$2,600.
- Balance of Interest Income at balance day: \$500.

Required tasks:

a. Use the information provided to complete the ledger account below.

Accrued Interest Income					
Date	Description	\$	Date	Description	\$

Interest Income					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

d. What is the value within the Accrued Interest Income ledger that will contribute to the Statement of Cash Flows or Cash Budget?

Note: This question is relevant for year 12 syllabus.

Practice Questions

Questions 58-68: Accrued Income.

Question 58

Calculate the income received at the end of the term deposit. Round calculations to the nearest whole number.

	Deposit	Interest rate per year	Period of Investment	Interest received at end of investment
a	2,000	10%	6 months	$= 2,000 \times [(0.1 \times (6/12))]$ $= \$100$
b	500	7%	12 months	
c	15,000	8%	6 months	
d	40,000	5%	3 months	
e	120,000	10%	12 months	

Question 59

Calculate the accrued interest income at balance day. Round calculations to the nearest whole number.

	Income received at end of investment	Elapsed Investment Period at balance day	Total Investment Period	Accrued Interest Income
a	\$6,500	2 months	12 months	$= 6,500 \times 2/12$ $= \$1,083$
b	\$2,800	4 months	6 months	
c	\$1,900	7 months	12 months	
d	\$12,000	3 months	6 months	
e	\$900	1 month	6 months	

Question 60

On 1 January 2039, a business invested in a 12 month term deposit that receives \$500 in interest income at the end of the period.

Required tasks:

a. Prepare the general journal entries to adjust the accrued income account as at 30 June 2039 and record the payment of the accrued income in the following period.

Workings

Date	Details	Debit	Credit

b. Prepare the general ledger entries to adjust the accrued income account as at 30 June 2039 and record the payment of the accrued income in the following period.

Accrued Interest Income					
Date	Description	\$	Date	Description	\$

Interest Income					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Cash at Bank					
Date	Description	\$	Date	Description	\$

c. Demonstrate the accrued income in the balance sheet as at 30 June 2039.

Balance Sheet as at 30 June 2039		
Current Assets		
Accrued Interest		

Question 61

On 1 February 2046, a business invests in a term deposit that pays \$240 interest every two months for 12 months.

Required tasks:

a. Prepare the general journal entries to adjust the accrued income account as at 30 June 2046 and record the payment of the accrued income in the following period.

Workings

Date	Details	Debit	Credit

b. Prepare the general ledger entries to demonstrate the interest income and adjust the accrued income account as at 30 June 2046 and record the payment of the accrued income in the following period.

Accrued Interest Income					
Date	Description	\$	Date	Description	\$

Interest Income					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Cash at Bank					
Date	Description	\$	Date	Description	\$

c. Demonstrate the accrued income in the balance sheet as at 30 June 2046.

Balance Sheet as at 30 June 2046		
Current Assets		
Accrued Interest		

Question 62

On 1 March 2038 a business invested in \$25,000 in a 6 month term deposit that earns 5% interest per annum. 3 months after the term deposit was made, half of the interest payment had been received. The remainder of the interest income will be received 6 months after the term deposit was initially made.

Required tasks:

a. Prepare the general journal entries to adjust the accrued income account as at 30 June 2038 and record the payment of the accrued income in the following period.

Workings

Date	Details	Debit	Credit

b. Prepare the general ledger entries to demonstrate the interest income received during the period, adjust the accrued income account as at 30 June 2038 and record the payment of the accrued income in the following period.

Accrued Interest Income					
Date	Description	\$	Date	Description	\$

Interest Income					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Cash at Bank					
Date	Description	\$	Date	Description	\$

c. Demonstrate the accrued income in the balance sheet as at 30 June 2038.

Balance Sheet as at 30 June 2038		
Current Assets		
Accrued Interest		

Question 63

Describe nature of accrued income. In your response, discuss how accrued income meets the relevant conceptual framework definition.

Question 64

Describe the purpose of the accrued income balance day adjustment. In your response, describe the effect on the balance sheet and income statement if the accrued income adjustment was not carried out.

Question 65

Describe the effect on the balance sheet and income statement of carrying out the accrued income adjustment.

Question 66

List the account created when carrying out the accrued income adjustment and the recognition criteria that creates this account.

Question 67

Information provided on 30 June 2050:

- Interest income was \$6,800.
- Accrued interest income was \$580.

Required task:

- Calculated the interest income.
- State the accrued interest income included in the balance sheet in the assets section.

Workings

Question 68

Trial balance (extract) As at 30 June 2050		
	Debit \$	Credit \$
Accrued Income	1,200	
Interest Income	800	

Additional Information

- Accrued income on 30 June 2050 was adjusted to \$750.

- Calculated the interest income.
- State the accrued interest income included in the balance sheet in the assets section.

Workings

Doubtful Debts

Businesses record credit sales within the accounts receivable account. It is important for businesses to review accounts receivable to identify debts which are unlikely to be received or will definitely not be received.

- Doubtful debts are debts that are predicted to be uncollectable and may turn into a bad debt.
- Bad debts are debts that will not be received.

This section will cover:

- Method of Calculating Doubtful Debts (extension).
- Allowance for Doubtful Debts – Creation.
- Allowance for Doubtful Debts – Adjustment.

Doubtful Debts – Nature and Purpose

Theory		Doubtful debts
Nature	Conceptual Framework category of original account	Expense.
	How this account meets the conceptual framework definition?	<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.
	Recognition process that creates the account	Derecognition of current asset (accounts receivable).
Purpose (of the adjusting entry)	Purpose overview	To record debtors who are unlikely to pay their accounts.
	Effect on Balance Sheet	<ul style="list-style-type: none"> • Current asset decreased.
	Effect on Income Statement	<ul style="list-style-type: none"> • Expenses increased. • Profit decreased.
	Effect on balance sheet if not accounted for	<ul style="list-style-type: none"> • Current assets (debtors) overestimated.
	Effect on income statement if not adjusted on balance day	<ul style="list-style-type: none"> • Expenses underestimated. • Profit overestimated.

Doubtful Debts – Calculation Methods

The syllabus does not include methods used by businesses to calculate the doubtful debts expense. The following calculation methods are covered as extension. After this section, the value of doubtful debts will be given, rather than requiring calculation.

- Review of Individual Debtors Method.
- Accounts Receivable Aging Method.
- Percentage of Accounts Receivable Method.

Review of Individual Debtors Method

This method involves reviewing each of the debtors that make up accounts receivable and reviewing if specific debtors should be considered as doubtful debts.

Example

On 30 June 2035, a business had \$67,000 of accounts receivable. Upon review of individual debtors, the following debtors were considered doubtful debts.

- J. Smith \$2,500
- H. Wallace \$900

Doubtful debts = 2,500 + 900
= \$3,400

Therefore, doubtful debts expense is \$3,400.

Example – Accounts Receivable Aging Method

This method involves grouping debtors that make up accounts receivable based on age of the debt, usually 30 day intervals. Each group of debtors is applied a percentage to estimate that amount of that is a doubtful debt.

Example

The table below categories each group of debtors and applies a percentage to each group to calculate the estimated doubtful debts.

Length of time debt has been outstanding	Total debt of each group	Percentage considered doubtful	Estimated doubtful debts
0-30 days	30,000	1%	300
31-60 days	16,000	5%	800
61-90 days	9,000	15%	1,350
Over 90 days	4,000	25%	1,000
	\$59,000		\$3,450

Therefore, doubtful debts expense is \$3,450.

Example – Percentage of Accounts Receivable Method

This method involves multiplying accounts receivable by a flat rate to estimate the doubtful debts expense.

Example

On 30 June 2028, a business has accounts receivable of \$50,000. The business estimates that 4% of accounts receivable are doubtful debts.

Doubtful debts expense = 50,000 x 0.04
= \$2,000

Therefore, doubtful debts expense is \$2,000.

Allowance for Doubtful Debts – Creation

When doubtful debts are calculated, these are accounted for in the doubtful debts accounts and the allowance for doubtful debts account.

Example

Wheatbelt Farm Supplies had provided the following information.

- On 30 June 2042, accounts receivable was \$43,000. The doubtful debts have been calculated as \$6,000.

Required task:

- Prepare the general journal and general ledger entries to adjust the allowance for doubtful debts account as at 30 June 2042.
- Demonstrate allowance for doubtful debts on the balance sheet as at 30 June 2042.

Solution

Step 1 – Doubtful Debts Adjustment.

When doubtful debts are adjusted, the allowance for doubtful debts account is created. Doubtful debts do not directly reduce accounts receivable as there is still a possibility that these debts may be received.

- Debit Doubtful Debts \$6,000 to increase this expense account.
- Credit Allowance for Doubtful Debts \$6,000 to increase this contra asset account.

Date	Details	Debit	Credit
30 Jun 2042	Doubtful Debts	6,000	
	Allowance for Doubtful Debts		6,000
	Allowance for doubtful debts creation		

Doubtful Debts					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Allowance for Doubtful Debts	6,000			

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$
			30 Jun 2042	Doubtful Debts	6,000

Step 2 – Doubtful Debts to Profit and Loss Account.

The doubtful debts account is transferred to the profit and loss account.

- Debit Profit and Loss \$6,000 to this working account.
- Credit Doubtful Debts \$6,000 to close this expense account.

The Doubtful Debts figure of \$6,000 will appear in the income statement within the Selling and Distribution expenses category.

Date	Details	Debit	Credit
30 Jun 2042	Profit and Loss	6,000	
	Doubtful Debts		6,000
	Expense transferred		

Profit and Loss					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Doubtful Debts	6,000			

Doubtful Debts					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Allowance for Doubtful Debts	6,000	30 Jun 2042	Profit and Loss	6,000

Step 3 – Allowance for Doubtful Debts in the Balance Sheet.

Allowance for Doubtful Debts is a contra asset account and appears beneath accounts receivable in the balance sheet.

Wheatbelt Farm Supplies		
Balance Sheet		
as at 30 June 2042		
Current Assets		
Accounts Receivable	43,000	
Less Allowance for Doubtful Debts	(6,000)	37,000

Practice Questions

Questions 69-73: Allowance for Doubtful Debts – Creation.

Question 69

On 30 June 2027, a business had accounts receivable of \$65,000. The business decided that doubtful debts is \$4,000.

Required tasks:

a. Prepare the general journal entries to adjust the allowance for doubtful debts account as at 30 June 2027.

Date	Details	Debit	Credit

b. Prepare the general ledger entries to adjust the allowance for doubtful debts account as at 30 June 2027.

Doubtful Debts					
Date	Description	\$	Date	Description	\$

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

c. Demonstrate accounts receivable and allowance for doubtful debts on the balance sheet as at 30 June 2042.

Balance Sheet as at 30 June 2042		
Current Assets		
Accounts Receivable		
Allowance for Doubtful Debts		

Question 70

On 30 June 2045, a business had accounts receivable of \$103,000. The business has decided to create an allowance for doubtful debts of \$2,700.

Required tasks:

a. Prepare the general journal entries to adjust the allowance for doubtful debts account as at 30 June 2027.

Date	Details	Debit	Credit

b. Prepare the general ledger entries to adjust the allowance for doubtful debts account as at 30 June 2027.

Doubtful Debts					
Date	Description	\$	Date	Description	\$

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

c. Demonstrate accounts receivable and allowance for doubtful debts on the balance sheet as at 30 June 2042.

Balance Sheet as at 30 June 2045		
Current Assets		
Accounts Receivable		
Allowance for Doubtful Debts		

Question 71

Describe nature of doubtful debts. In your response, discuss how doubtful debts meets the relevant conceptual framework definition.

Question 72

Describe the purpose of the doubtful debts balance day adjustment. In your response, describe the effect on the balance sheet and income statement if the doubtful debts adjustment was not carried out.

Question 73

Describe the effect on the balance sheet and income statement of carrying out the doubtful debts adjustment.

Allowance for Doubtful Debts – Adjustment

In the previous section, the allowance for doubtful debts was created. Once debts are written off as bad debts, these are written off with an entry associated with the allowance for doubtful debts account. Bad debts are not transferred to profit and loss because these were accounted for as a doubtful debt expense in the previous accounting period. If the balance of the allowance for doubtful debts reaches zero, the bad debts remaining is transferred to the profit and loss account for the given accounting period. Businesses can adjust the allowance for doubtful debts to increase or decrease each accounting period.

- Example 1 – In this example, bad debts are written off prior to adjusting the allowance for doubtful debts.
- Example 2 – In this example, bad debts already exist at balance day and further bad debts are written off prior to adjusting the allowance for doubtful debts.

Example 1 – Write-off of Bad Debts and Adjusting the Allowance for Doubtful Debts

The following information has been provided by Wheatbelt Farm Supplies.

- On 30 June 2041, the allowance for doubtful debts was established at \$400.
- On 25 June 2042, bad debts were written off with a value of \$150. At this time, accounts receivable had a balance of \$60,000.

Additional information

- The allowance for doubtful debts is to be adjusted to \$600.

Required task:

Prepare the general journal and general ledger entries to write-off the bad debts and adjust the allowance for doubtful debts.

Solution

Step 1 – Write-off of Bad Debts.

The bad debts are written off with entries to the bad debts and accounts receivable accounts.

- Debit Bad Debts \$150 to increase this expense account.
- Credit Accounts Receivable \$150 to decrease this asset account.

Note: The entry that is not bolded in each account is the original balance at balance day.

Date	Details	Debit	Credit
25 Jun 2042	Bad Debts	150	
	Accounts Receivable		150
	Write-off of bad debts		

Bad Debts					
Date	Description	\$	Date	Description	\$
25 Jun 2042	Accounts Receivable	150			

Accounts Receivable					
Date	Description	\$	Date	Description	\$
25 Jun 2042	Balance	60,000	25 Jun 2042	Bad Debts	150

Step 2 – Bad Debts Expense to Allowance for Doubtful Debts Account.

The bad debts are transferred to the allowance for doubtful debts account.

- Debit Allowance for Doubtful Debts \$150 to decrease this contra asset account.
- Credit Bad Debts \$150 to close this expense account.

The bad debts account is not transferred to the profit and loss account because this would have been accounted for as a component of the doubtful debts expense during the previous account period.

Note: The credit entry in the allowance for doubtful debts account that is not bolded represents the amount that the allowance for doubtful debts was set to during the previous accounting period.

Note: the entry in bad debts that is not bolded is from the previous step.

Date	Details	Debit	Credit
30 Jun 2042	Allowance for Doubtful Debts	150	
	Bad Debts		150
	Bad debts transferred		

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Bad Debts	150	30 Jun 2041	Doubtful Debts	400

Bad Debts					
Date	Description	\$	Date	Description	\$
20 Jun 2042	Accounts Receivable	150	30 Jun 2042	Allowance for Doubtful Debts	150

Step 3 – Allowance for Doubtful Debts Adjustment.

Part A: The allowance for doubtful debts is to be adjusted to \$600 and this is entered as the balance c/d figure in this account. The account is then totalled.

Part B: The difference between the credit side and the total is an entry to the doubtful debts account.

- Debit Doubtful Debts \$350 to increase this expense account.
- Allowance for Doubtful Debts \$350 to increase this contra asset account.

Note: the entry that is not bolded in the allowance for doubtful debts account is from the previous step.

Date	Details	Debit	Credit
30 Jun 2042	Doubtful Debts	350	
	Allowance for Doubtful Debts		350
	Allowance for doubtful debts adjusted to \$600.		

Doubtful Debts					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Allowance for Doubtful Debts	350			

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Bad Debts	150	30 Jun 2041	Doubtful Debts	400
	Balance c/d	600	30 Jun 2042	Doubtful Debts	350
		750			750
				Balance b/d	600

Step 4 – Doubtful Debts to Profit and Loss Account.

The doubtful debts account is transferred to the profit and loss account.

- Debit Profit and Loss \$350 to this working account.
- Credit Doubtful Debts \$350 to close this expense account.

Date	Details	Debit	Credit
30 Jun 2042	Profit and Loss	350	
	Doubtful Debts		350
	Expense transferred		

Profit and Loss					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Doubtful Debts	350			

Doubtful Debts					
Date	Description	\$	Date	Description	\$
30 Jun 2042	Allowance for Doubtful Debts	350	30 Jun 2042	Profit and Loss	350

Step 3 – Allowance for Doubtful Debts Adjustment.

Part a. The allowance for doubtful debts is to be adjusted to \$900 and this is entered as the balance c/d figure in this account. The account is then totalled.

Part b. The difference between the credit side and the total is an entry to the doubtful debts account.

- Debit Doubtful Debts \$1,000 to increase this expense account.
- Credit Allowance for Doubtful Debts \$1,000 to increase this contra asset account.

Date	Details	Debit	Credit
30 Jun 2043	Doubtful Debts Allowance for Doubtful Debts Allowance for doubtful debts adjusted to \$900.	1,000	1,000

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$
30 Jun 2043	Bad Debts	700	30 Jun 2043	Balance	600
30 Jun 2043	Balance c/d	900	30 Jun 2043	Doubtful Debts	1,000
		1,600			1,600
			1 Jul 2043	Balance b/d	900

Doubtful Debts					
Date	Description	\$	Date	Description	\$
30 Jun 2043	Allowance for Doubtful Debts	1,000			

Step 4 – Doubtful Debts to Profit and Loss Account.

The doubtful debts account is transferred to the profit and loss account.

- Debit Profit and Loss \$1,000 to this working account.
- Credit Doubtful Debts \$1,000 to close this expense account.

Date	Details	Debit	Credit
30 Jun 2043	Profit and Loss Doubtful Debts Expense transferred	1,000	1,000

Profit and Loss					
Date	Description	\$	Date	Description	\$
30 Jun 2043	Doubtful Debts	1,000			

Doubtful Debts					
Date	Description	\$	Date	Description	\$
30 Jun 2043	Allowance for Doubtful Debts	1,000	30 Jun 2043	Profit and Loss	1,000



View from Kitzsteinhorn glacier gondola, Austria.

Practice Questions

Questions 74-79: Allowance for Doubtful Debts general ledger calculations.

Questions 80-88: Allowance for Doubtful Debts – Adjustment.

Practical Summary

A practical summary for doubtful debts has been provided as a reference to support completing initial practice questions.

Tip Complete the A.D.D. ledger account first

You do not necessarily have to complete the journals and ledgers in the order you see them in the question. You may find it easier to complete the Allowance for Doubtful Debts ledger account first. Completing the A.D.D. ledger account first will allow you to calculate figures you need for the journals as well as serve as reminders for which entries are required in other ledger and journal accounts.

Doubtful Debts – Practical Summary

Adjustment	Account to adjust	What to do	Workings	Account	Where adjustment goes						
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	<table border="1"> <tr> <td colspan="2">Allowance for Doubtful Debts</td> </tr> <tr> <td>Bad Debts</td> <td>O Bal</td> </tr> <tr> <td>C Bal</td> <td>Doubtful Debts</td> </tr> </table>	Allowance for Doubtful Debts		Bad Debts	O Bal	C Bal	Doubtful Debts	Closing Balance • Balance Sheet. Doubtful debts / Bad Debts • Income statement.
Allowance for Doubtful Debts											
Bad Debts	O Bal										
C Bal	Doubtful Debts										

Question 74

A business has provided the following information:

- The opening balance of Allowance for Doubtful Debts was \$3,000.
- During the year bad debts of \$2,000 were written off.
- The Allowance for Doubtful Debts is to be set at \$2,500.

Required tasks:

a. Use the information provided to complete the ledger account below.

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Question 75

A business has provided the following information:

- The initial balance of bad debts was \$300.
- Accounts Receivable at balance day was \$16,000.
- Further bad debts of \$800 are to be written off.
- Allowance for Doubtful Debts opening balance: \$1,700
- Allowance for Doubtful Debts is to be set at \$1,200

Required tasks:

a. Use the information provided to complete the ledger account below.

Workings

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

c. What is the value of Accounts Receivable that will appear on the balance sheet?

Workings

Question 76

A business has provided the following information:

- Bad debts balance was \$650
- Balance of Accounts Receivable: \$24,300.
- Further bad debts of \$900 are to be written off at balance day.
- Allowance for Doubtful Debts opening balance: \$1,200
- Allowance for Doubtful debts to be adjusted to \$1,500

Required tasks:

a. Use the information provided to complete the ledger account below.

Workings

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

c. What is the value of Accounts Receivable that will appear on the balance sheet?

Workings

Question 77

A business has provided the following information:

- Allowance for Doubtful Debts is to be created at \$600.

Required tasks:

a. Use the information provided to complete the ledger account below.

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Question 78

A business has provided the following information:

- Allowance for Doubtful Debts was created earlier in the year at \$500.
- During the year Bad Debts of \$300 were written off shortly after and an additional \$100 of Bad Debts was written off on balance day.
- Accounts Receivable at balance day was \$41,200.
- The Allowance for Doubtful Debts is to remain set at \$500.

Required tasks:

a. Use the information provided to complete the ledger account below.

Workings

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

c. What is the value of Accounts Receivable that will appear on the balance sheet?

Workings

Question 79

A business has provided the following information:

- Allowance for Doubtful Debts was created during the previous by recognising \$400 of Doubtful Debts.
- The Allowance for Doubtful Debts is to be set to \$600.
- Bad Debts written off during the period: \$250.

Required tasks:

a. Use the information provided to complete the ledger account below.

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

b. What is the value that will appear on the income statement?

c. What is the value that will appear on the balance sheet?

Practice Questions

Questions 80-88: Allowance for Doubtful Debts – Adjustment.

Question 80

Calculate either the doubtful debts or bad debts in the table below.

	Opening A.D.D.	Bad Debts	Doubtful Debts	Closing A.D.D.
a	10,000	7,000	= 7,000 + 12,000 - 10,000 = \$9,000	12,000
b	3,400	= 3,400 + 2,000 - 3,800 = \$1,600	2,000	3,800
c	2,000	3,000		3,500
d	400	600		800
e	2,400		2,000	2,500
f	6,900		7,300	8,000

b. Prepare the general ledger entries to write-off the bad debts and adjust the allowance for doubtful debts.

Bad Debts					
Date	Description	\$	Date	Description	\$

Accounts Receivable					
Date	Description	\$	Date	Description	\$

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

Doubtful Debts					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

Doubtful Debts					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

c. Complete the balance sheet extract below.

Balance Sheet (extract) As at 30 June 2053		
Current Assets		
Accounts Receivable		
Less Allowance for Doubtful Debts		

d. Complete the income statement extract below.

Income statement (extract) For the year ended 30 June 2053	
Selling and Distribution Expenses	
Doubtful Debts	

Question 83

A business has provided the following information for the year ended 30 June 2032.

- Bad debts \$750.
- Accounts Receivable \$54,000.
- Allowance for Doubtful Debts \$900.

Additional information

- Additional bad debts of \$330 are to be written off.
- Allowance for doubtful debts is to be adjusted to \$1,500.

Required tasks:

a. Prepare the general journal entries to write-off the additional bad debts and adjust the allowance for doubtful debts.

Date	Details	Debit	Credit

b. Prepare the general ledger entries to write-off the additional bad debts and adjust the allowance for doubtful debts.

Bad Debts					
Date	Description	\$	Date	Description	\$

Accounts Receivable					
Date	Description	\$	Date	Description	\$

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

Doubtful Debts					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Accounts Receivable					
Date	Description	\$	Date	Description	\$

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

Doubtful Debts					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

c. Complete the balance sheet extract below.

Balance Sheet (extract) As at 30 June 2053		
Current Assets		

d. Complete the income statement extract below.

Income statement (extract) For the year ended 30 June 2053	
Expenses	

Question 85

Trial balance (extract) As at 30 June 2050		
	Debit \$	Credit \$
Accounts Receivable	80,000	
Allowance for Doubtful Debts		8,000
Bad Debts	3,000	

Additional information

- The allowance for doubtful debts is to be adjusted to \$9,500.

Required task:

Calculate the doubtful debts expense.

Workings

Question 86

Trial balance (extract) As at 30 June 2050		
	Debit \$	Credit \$
Accounts Receivable	36,000	
Allowance for Doubtful Debts		2,700
Bad Debts	1,200	

Additional information

- The allowance for doubtful debts is to be adjusted to \$2,300.

Required task:

Calculate the doubtful debts expense.

Workings

Balance Day Adjustment extended journal and ledger questions.

The following questions are elaborated questions which require the calculation of multiple balance day adjustments and entry of these in the general journal and general ledger.

Practice Questions

Questions 87-90: Balance Day Adjustment extended journal and ledger questions.

Note: the syllabus does not require balance day adjustments to be completed with GST entries. To replicate assessment conditions, GST is not included in these questions or the solutions.

Course Guide

Refer to Course Guide Balance Day Adjustments Practical Summary example ledger accounts to help prompt ideas for more challenging questions.

Workings

Show workings to calculate the value of both the asset or liability and income or expense account for each balance day adjustment.

Review

If you are finding these extended questions difficult, take note of which balance day adjustments are difficult. Then go back to revise questions from earlier in the chapter that focus on that balance day adjustment.

Question 87

The following information has been provided by a business.

Wango Bango Pty Ltd Trial Balance (extract) As at 30 June 2052		
	Debit	Credit
Prepaid insurance	2,400	
Term deposit	10,000	
Bad debts	600	
Accounts Receivable	19,000	
Unearned income		27,000
Capital		29,000
Staff wages	9,000	
Allowance for doubtful debts		1,300

Additional information:

- Staff wages owing is \$1,000.
- Adjust the allowance for doubtful debts to \$1,700.
- Prepaid insurance was paid for 12 months and was paid on 1 October 2051.
- The term deposit pays 5% interest at the end of 12 months. The term deposit was paid for on 1 January 2052.
- Fees of \$12,000 had been earned.

Required tasks:

- Calculate asset or liability and income or expense account closing values for the relevant balance day adjustments.
- Prepare the general journal entries required for the above balance day adjustments.
- Prepare the current assets and current liabilities section of the balance sheet as at 30 June 2052.
- Prepare the general journal entry for the receipt of accrued interest income in the next accounting period.

Insurance					
Date	Description	\$	Date	Description	\$

Prepaid Insurance					
Date	Description	\$	Date	Description	\$

Staff wages					
Date	Description	\$	Date	Description	\$

Accrued staff wages					
Date	Description	\$	Date	Description	\$

Accrued Interest Income					
Date	Description	\$	Date	Description	\$

Interest Income					
Date	Description	\$	Date	Description	\$

Unearned Income					
Date	Description	\$	Date	Description	\$

Fees					
Date	Description	\$	Date	Description	\$

Accounts Receivable					
Date	Description	\$	Date	Description	\$

Bad Debts					
Date	Description	\$	Date	Description	\$

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

Doubtful Debts					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Capital					
Date	Description	\$	Date	Description	\$

Current Assets		
Prepaid Insurance		
Accrued Interest Income		
Accounts Receivable		
Less Allowance for Doubtful Debts		
Total Current Assets		

Current Liabilities		
Accrued staff wages		
Unearned Income		
Total Current Liabilities		

Question 88

A business has provided the following information.

Flippity Floopity Traders Trial Balance (extract) As at 30 June 2039		
	Debit	Credit
Prepaid water	600	
Sales		154,250
Accounts Receivable	51,700	
Bad Debts	500	
Allowance for Doubtful Debts		3,200
Office space	60,000	
Internet expense	1,050	
Rental income	8,800	
Capital		36,000

Additional information:

- The business rents out office space for income and is paid every two months. Rental income of \$1,600 was last paid for on 1 June 2039.
- Internet of \$450 is paid once every three months at the end after it has been used. Internet was last paid on 30 April 2039.
- The prepaid water at balance day was \$200.
- Write off further bad debts of \$300
- The allowance for doubtful debts is to be set to \$3,300.

Required tasks:

- a) Calculate asset or liability and income or expense account values for the relevant balance day adjustments.
- b) Prepare the general journal entries required for the above balance day adjustments.
- c) Prepare the general ledger entries required for the above balance day adjustments.
- d) Prepare the current assets and current liabilities section of the balance sheet.
- e) Record and process the general journal and general ledger entries of the next payment of any accrued expenses or receipt of any accrued income in the next accounting period.

Workings

Water expense					
Date	Description	\$	Date	Description	\$

Prepaid water					
Date	Description	\$	Date	Description	\$

Internet expense					
Date	Description	\$	Date	Description	\$

Accrued Internet expense					
Date	Description	\$	Date	Description	\$

Accrued Rental Income					
Date	Description	\$	Date	Description	\$

Rental Income					
Date	Description	\$	Date	Description	\$

Accounts Receivable					
Date	Description	\$	Date	Description	\$

Bad Debts					
Date	Description	\$	Date	Description	\$

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

Doubtful Debts					
Date	Description	\$	Date	Description	\$

Sales					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Capital					
Date	Description	\$	Date	Description	\$

Cash at Bank					
Date	Description	\$	Date	Description	\$

Current Assets		
Total Current Assets		

Current Liabilities		
Total Current Liabilities		

Question 89

The following information has been provided by a business.

Know Da Way Sonic Trial Balance (extract) As at 30 June 2067		
	Debit	Credit
Prepaid advertising	1,200	
Advertising expense	150	
Fees		60,000
Unearned income		19,000
Accounts receivable	21,000	
Fixed interest income asset	16,000	
Capital		167,000
Electricity expense	4,590	

Additional information:

- Doubtful debts are calculated to be \$900.
- Electricity of \$180 is paid every fortnight after it has been used. The last payment for electricity took place on 23 June 2067.
- The advertising expense at balance day was \$500.
- On 30 May 2067 the business purchased a fixed interest income producing asset which pays \$900 every three months.
- Closing unearned income was \$3,000.

Required tasks:

- a) Calculate asset or liability and income or expense account values for the relevant balance day adjustments.
- b) Prepare the general journal entries required for the above balance day adjustments.
- c) Prepare the general ledger entries required for the above balance day adjustments.
- d) Prepare the current assets and current liabilities section of the balance sheet as at 30 June 2067.
- e) Record and process the general journal and general ledger entries of the next payment of any accrued expenses or receipt of any accrued income in the next accounting period.

Workings

Advertising expense					
Date	Description	\$	Date	Description	\$

Prepaid advertising					
Date	Description	\$	Date	Description	\$

Electricity expense					
Date	Description	\$	Date	Description	\$

Accrued electricity					
Date	Description	\$	Date	Description	\$

Interest income					
Date	Description	\$	Date	Description	\$

Accrued interest income					
Date	Description	\$	Date	Description	\$

Unearned Income					
Date	Description	\$	Date	Description	\$

Fees					
Date	Description	\$	Date	Description	\$

Doubtful Debts					
Date	Description	\$	Date	Description	\$

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Capital					
Date	Description	\$	Date	Description	\$

Cash at Bank					
Date	Description	\$	Date	Description	\$

Current Assets		

Current Liabilities		

Question 90

The following information has been provided by a business.

Kendoll Barb Wire Trial Balance (extract) As at 30 June 2046		
	Debit	Credit
Cleaning supplies	900	
Sales		194,200
Accounts Receivable	59,000	
Interest income		900
Term deposit	8,000	
Wages	27,000	
Capital		35,000
Bad debts	650	
Allowance for doubtful debts		2,450

Additional information:

- Write off further bad debts of \$250
- The allowance for doubtful debts is to be set to \$2,900.
- Wages of staff owing on balance day was \$1,900.
- Cleaning supplies on hand on balance day was \$350.
- The business receives 7.5% interest on the term deposit every four months. The most recent interest payment was received on 30 April 2046.

Required tasks:

- Calculate asset or liability and income or expense account values for the relevant balance day adjustments.
- Prepare the general journal entries required for the above balance day adjustments.
- Prepare the general ledger entries required for the above balance day adjustments.
- Prepare the current assets and current liabilities section of the balance sheet as at 30 June 2046.
- Record and process the general journal and general ledger entries of the receipt of any accrued income in the next accounting period.

Workings

Cleaning supplies expense					
Date	Description	\$	Date	Description	\$

Cleaning supplies					
Date	Description	\$	Date	Description	\$

Wages					
Date	Description	\$	Date	Description	\$

Accrued wages					
Date	Description	\$	Date	Description	\$

Accrued interest income					
Date	Description	\$	Date	Description	\$

Interest income					
Date	Description	\$	Date	Description	\$

Bad debts					
Date	Description	\$	Date	Description	\$

Accounts Receivable					
Date	Description	\$	Date	Description	\$

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$

Doubtful Debts					
Date	Description	\$	Date	Description	\$

Sales					
Date	Description	\$	Date	Description	\$

Profit and Loss					
Date	Description	\$	Date	Description	\$

Capital					
Date	Description	\$	Date	Description	\$

Cash at Bank					
Date	Description	\$	Date	Description	\$

Current Assets		

Current Liabilities		

15. Classified Financial Statements with Balance Day Adjustments

Classified Financial Statements with Balance Day Adjustments – Syllabus

Syllabus – Unit 2	
Classified Financial Statements with Balance Day Adjustments	Recording, processing and communicating financial information <ul style="list-style-type: none">• manual preparation of trial balance• manual preparation of classified financial statements for a sole trader, including balance day adjustments<ul style="list-style-type: none">▪ income statements▪ statement of financial position for a trading/merchandising/service business

Classified Financial Statements with Balance Day Adjustments – Introduction

This chapter will cover the preparation of the following classified financial statements with balance day adjustments:

- Income Statement.
- Balance Sheet.



Fushimi Inari, Kyoto.

Preparation of the Balance Sheet and Income Statement with Balance Day Adjustments

Once balance day adjustments have been taken place, the balance sheet and income statement can be accurately prepared.

Example

The following information has been provided by Silk Styles.

Silk Styles Trial Balance as at 30 June 2037		
	Debit	Credit
Allowance for Doubtful Debts		900
Wages	7,000	
Bad Debts	750	
Prepaid Insurance	3,200	
Motor Vehicle	24,000	
Accumulated Depreciation of Motor Vehicle		9,000
Office Supplies	1,200	
Freight Outwards	300	
Advertising	800	
Rent	6,300	
Interest Expense	200	
Cost of Sales	52,000	
Freight Inwards	200	
Sales		94,500
Gain on Sale of Investments		7,000
Discount Received		900
Accounts Receivable	6,500	
Cash at Bank	7,000	
Inventory	50,300	
GST Payable		2,300
Loan from Bank		10,000
Accounts Payable		2,900
Capital		50,000
Drawings	16,350	
Sales Returns	1,400	
	\$177,500	\$177,500

Additional Information

- Prepaid insurance remaining was \$800.
- The allowance for doubtful debts is to be set to \$1,200.
- Wages owed were \$300.
- Office supplies expense at balance day was \$700.
- Motor vehicle is to be depreciation at 10% per annum using the reducing balance method.

Required task:

Prepare a balance sheet as at 30 June 2037.

Prepare an income statement for the year ended 30 June 2037.

Solution

Step 1 – Calculation of Balance Day Adjustments.

Given this question does not require the preparation of general journal or general ledger entries, the balance day adjustments can be calculated either using the formula layout or the general ledger layout based on student preference.

Each balance day adjustment involves either an asset or liability and an income or expense account. When showing your workings, it is recommended to show workings for both impacted accounts for each balance day adjustment. A good way to check if a balance day adjustment has been done correctly, is to see if the change made to each involved trial balance account balances the accounting equation. I.e., if an asset account is adjusted to increase by \$1,000, then the adjusted income account must be increased by \$1,000 or if an expense account is involved this must decreased by \$1,000.

$$\begin{aligned}\text{Insurance expense} &= 3,200 - 800 \\ &= \$2,400\end{aligned}$$

$$\text{Prepaid insurance} = \$800$$

$$\begin{aligned}\text{Wages expense} &= 7,000 + 300 \\ &= \$7,300\end{aligned}$$

$$\text{Accrued wages} = \$300$$

$$\begin{aligned}\text{Office supplies} &= 1,200 - 700 \\ &= \$500\end{aligned}$$

$$\text{Office supplies expense} = \$700$$

$$\begin{aligned}\text{Depreciation of MV} &= (24,000 - 9,000) \times 0.1 \\ &= \$1,500\end{aligned}$$

$$\begin{aligned}\text{Accumulated Depreciation of MV} &= 9,000 + 1,500 \\ &= 10,500\end{aligned}$$

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$
	Bad Debts	750		Doubtful Debts	900
	Balance c/d	1,200		Doubtful Debts	1,050
		<u>1,950</u>			<u>1,950</u>
				Balance b/d	1,200

Therefore, doubtful debts expense = \$1,050.

Step 2 and 3 – Balance Sheet and Income Statement Preparation.

The balance sheet and income statement are prepared as demonstrated below.

Note: The profit calculated in the income statement is entered in the equity section of the balance sheet. The net assets and total equity should be equal.

Silk Styles Balance Sheet As at 30 June 2037			Silk Styles Income Statement for the year ended 30 June 2037			
Current Assets			Sales			94,500
Cash at Bank		7,000	Less Sales Returns			1,400
Inventory		50,300	Net Sales			93,100
Office Supplies		500	Less Cost of Sales	52,000		
Prepaid Insurance		800	Freight Inwards	200	52,200	
Accounts Receivable	6,500		Less Discount Received		900	51,300
Allowance for Doubtful Debts	(1,200)	5,300	Gross Profit			41,800
Total Current Assets		63,900	Add Other Income			
Non-Current Assets			Gain on Sale of Investments			7,000
Motor Vehicle	24,000		Total Income			48,800
Accumulated Depreciation of MV	(10,500)	13,500	<i>Less Other Expenses</i>			
Total Non-Current Assets		13,500	Selling and Distribution Expenses			
Total Assets		77,400	Advertising	800		
Current Liabilities			Freight Outwards	300		
Accounts Payable		2,900	Depreciation of MV	1,500		
GST Payable		2,300	Doubtful debts	1,050	3,650	
Accrued wages		300	General & Administration Expenses			
Total Current Liabilities		5,500	Office supplies expense	700		
Non-Current Liabilities			Rent	6,300		
Loan from Bank		10,000	Insurance	2,400		
Total Non-Current Liabilities		10,000	Wages	7,300	16,700	
Total Liabilities		15,500	Financial Expenses			
Net Assets		61,900	Interest expense	200	200	20,550
Equity			Net Profit			\$28,250
Capital		50,000				
Add Profit		28,250				
		78,250				
Less Drawings		16,350				
Total Equity		61,900				

Practice Questions

Questions 1-10: Preparation of the Balance Sheet and Income Statement with Balance Day Adjustments.

Balance Day Adjustments Summary

See the Balance Day Adjustments chapter of the Course Guide for summaries of both the theory and practical for all balance day adjustments. These also includes the summary for depreciation.

Balance Sheet and Income Statement Preparation

An example Balance Sheet and Income Statement has been provided on the following pages as a reference to assist with initial practice.

Workings

Always show your workings. Workings can help you receive marks, even if the final value is incorrect.

Workings for both accounts involved in an adjustment

Tips

Each balance day adjustment involves either an asset or liability and an income or expense account. When showing your workings, it is recommended to show workings for both impacted accounts for each balance day adjustment. A good way to check if a balance day adjustment has been done correctly, is to see if the change made to each involved trial balance account balances the accounting equation. I.e., if an asset account is adjusted to increase by \$1,000, then the adjusted income account must be increased by \$1,000 or if an expense account is involved this must decreased by \$1,000.

GST Credits and GST Payable

According to the syllabus balance day adjustments are not required to be completed with GST. GST Credits and GST Payable have been included in the trial balance of questions in this chapter for inclusion in financial statements. These questions do not require calculation of GST regarding balance day adjustments as per the syllabus. I.e., the GST figures in the trial balance need to be included the relevant sections of financial statements but no calculations should be required for GST regarding balance day adjustments.

Course Guide

Tip

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.



View of Mount Yōtei from Grand Hirafu, Niseko.

Balance Sheet / Statement of Financial Position – Statement Preparation

Note: This balance sheet includes balance day adjustments whereas the example in unit 1 did not.

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

Business Name Balance Sheet / Statement of Financial Position As at 30 June 20XX		
Current Assets		
Cash at Bank		X
Inventory		X
Stock of Supplies		X
Accrued Income		X
Prepaid expense (e.g., rent, advertising, insurance)		X
GST Credits		X
Accounts Receivable	X	
Allowance for Doubtful Debts	X	X
Total Current Assets		X
Non-Current Assets		
Office Furniture	X	
Accumulated Depreciation of OF	X	X
Motor Vehicle	X	
Accumulated Depreciation of MV	X	X
Total Non-Current Assets		X
Total Assets		X
Current Liabilities		
Accounts Payable		X
Unearned Income		X
GST Payable		X
Accrued expense (e.g., wages, electricity)		X
Total Current Liabilities		X
Non-Current Liabilities		
Mortgage		X
Loan from Bank		X
Total Non-Current Liabilities		X
Total Liabilities		X
Net Assets		X
Equity		
Capital		X
Add Profit		X
		X (C+AP)
Less Drawings		x
Total Equity		X

Tip Each Non-Current Asset and associated accumulated depreciation is a separate entry.

Income Statement – Statement Preparation

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

Business Name Income Statement for the year ended 30 June 20XX			
Sales or Fees			X
Less Sales Returns			X
Less Discount Allowed			X
Net Sales			X
Less Cost of Sales	X		
Freight (or cartage) Inwards	X		
Customs Duty	X	X	
Less Discount Received		X	X
Gross Profit			X
Add Other Income			
Gain on Sale of Land			X
Gain on Sale of Investments			X
Interest (income)			X
Total Income			X
<i>Less Other Expenses</i>			
Selling and Distribution Expenses			
Advertising	X		
Freight Outwards	X		
Distribution vehicle service costs	X		
Petrol & oil	X		
Depreciation of vehicles	X		
Salaries of salespeople	X		
Doubtful debts	X	SD TOTAL	
General & Administration Expenses			
Office supplies	X		
Rent	X		
Telephone	X		
Insurance	X		
Depreciation of fixtures & fittings	X		
Salaries of office staff	X	GA TOTAL	
Financial Expenses			
Bank Fees	X		
Interest (e.g., on Loan/Mortgage)	X	FE TOTAL	SD+GA+FE
Net Profit			TI – OE

Question 1

The following information has been provided by Silk Styles.

Silk Styles Trial Balance as at 30 June 2037		
	Debit	Credit
Allowance for Doubtful Debts		900
Wages	7,000	
Bad Debts	750	
Prepaid Insurance	3,200	
Motor Vehicle	24,000	
Accumulated Depreciation of Motor Vehicle		9,000
Capital		
Office Supplies	1,200	
Freight Outwards	300	
Advertising	800	
Rent	6,300	
Interest Expense	200	
Cost of Sales	52,000	
Freight Inwards	200	
Sales		94,500
Gain on Sale of Investments		7,000
Discount Received		900
Accounts Receivable	6,500	
Cash at Bank	7,000	
Inventory	50,300	
GST Payable		2,300
Loan from Bank		10,000
Accounts Payable		2,900
Capital		50,000
Drawings	16,350	
Sales Returns	1,400	
	\$177,500	\$177,500

Additional Information

- Prepaid insurance remaining was \$800.
- The allowance for doubtful debts is to be set to \$1,200.
- Wages owed were \$300.
- Office supplies expense at balance day was \$700.
- Motor vehicle is to be depreciation at 10% per annum using the reducing balance method.

Required task:

a. Calculate the balance day adjustments.

Workings

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$
	Bad Debts			Doubtful Debts	
	Balance c/d			Doubtful Debts	
				Balance b/d	

b. Prepare a balance sheet as at 30 June 2037.

Silk Styles Balance Sheet As at 30 June 2037		
Current Assets		
Cash at Bank		
Inventory		
Office Supplies		
Prepaid Insurance		
Accounts Receivable		
Allowance for Doubtful Debts		
Total Current Assets		
Non-Current Assets		
Motor Vehicle		
Accumulated Depreciation of MV		
Total Non-Current Assets		
Total Assets		
Current Liabilities		
Accounts Payable		
GST Payable		
Accrued wages		
Total Current Liabilities		
Non-Current Liabilities		
Loan from Bank		
Total Non-Current Liabilities		
Total Liabilities		
Net Assets		
Equity		
Capital		
Add Profit		
Less Drawings		
Total Equity		

c. Prepare an income statement for the year ended 30 June 2037.

Silk Styles Income Statement for the year ended 30 June 2037			
Sales			
Less Sales Returns			
Net Sales			
Less Cost of Sales			
Freight Inwards			
Less Discount Received			
Gross Profit			
Add Other Income			
Gain on Sale of Investments			
Total Income			
<i>Less Other Expenses</i>			
Selling and Distribution Expenses			
Advertising			
Freight Outwards			
Depreciation of motor vehicle			
Doubtful debts			
General & Administration Expenses			
Office supplies expense			
Rent			
Insurance			
Wages			
Financial Expenses			
Interest expense			
Net Profit			

Question 2

The following information has been provided by Timeless Framers.

Timeless Framers Trial Balance as at 30 June 2031		
	Debit	Credit
Capital		34,000
Cash at Bank	10,000	
Sales		68,000
Insurance	3,000	
Inventory	4,000	
Discount Received		800
Accounts Receivable	12,500	
Sales Returns	400	
GST Credits	600	
GST Payable		1,600
Machinery	20,000	
Accumulated Depreciation of Machinery		3,000
Rent	6,000	
Term deposit (6 months)	20,000	
Cartage inwards	300	
Accounts Payable		7,000
Interest income		1,200
Cost of Sales	26,400	
Sales staff wages	18,000	
Interest expense	300	
Bad debts	700	
Allowance for Doubtful Debts		2,000
Loan from Bank		16,600
Drawings	12,000	
	\$134,200	\$134,200

Additional information

- Machinery is depreciated using reducing balance method at a rate of 15% per year. The machinery is used in the business's administration office.
- Accrued interest income is \$100.
- Sales staff wages owed were \$1,700.
- Allowance for doubtful debts is to be set at \$3,200.

Required tasks:

a. Calculate the balance day adjustments.

Workings

Allowance for Doubtful Debts					
Date	Description	\$	Date	Description	\$
	Bad Debts			Balance	
	Balance c/d			Doubtful Debts	
				Balance b/d	

b. Prepare the balance sheet as at 30 June 2031.

Timeless Framers Balance Sheet as at 30 June 2031		
Current Assets		
Cash at Bank		
Inventory		
Term Deposit		
Accrued Interest Income		
GST Credits		
Accounts Receivable		
Allowance for Doubtful Debts		
Total Current Assets		
Non-Current Assets		
Machinery		
Accumulated Depreciation of Machinery		
Total Non-Current Assets		
Total Assets		
Current Liabilities		
Accounts Payable		
GST Payable		
Accrued sales staff wages		
Total Current Liabilities		
Non-Current Liabilities		
Loan from Bank		
Total Non-Current Liabilities		
Total Liabilities		
Net Assets		
Equity		
Capital		
Add Profit		
Less Drawings		
Total Equity		

c. Prepare the income statement for the year ended 30 June 2031.

Timeless Framers Income Statement for the period ended 30 June 2031			
Sales			
Less Sales Returns			
Net Sales			
Less Cost of Sales			
Cartage Inwards			
Less Discount Received			
Gross Profit			
Add Other Income			
Interest Income			
Total Income			
<i>Less Other Expenses</i>			
Selling and Distribution Expenses			
Sales staff wages			
Doubtful Debts			
General & Administration Expenses			
Depreciation of machinery			
Rent			
Insurance			
Financial Expenses			
Interest			
Net Profit			

Question 3

A business provided the following information as at 30 June 2035.

Sharp Screens Trial Balance as at 30 June 2035		
	Debit	Credit
Capital		60,000
Cash at Bank	75,000	
Insurance	1,200	
Inventory	16,000	
Discount Received		900
Accounts Receivable	90,000	
Sales Returns	200	
GST Credits	500	
GST Payable		2,400
Machinery	20,000	
Accumulated Depreciation of Machinery		5,000
Prepaid rent	9,000	
Wages	12,000	
Term deposit (6 months)	20,000	
Accounts Payable		25,000
Cleaning supplies	500	
Cost of Sales	9,000	
Bad debts	200	
Bank fees	100	
Allowance for Doubtful Debts		500
Loan from Bank		60,000
Drawings	4,600	
Sales		104,700
Discount allowed	200	
	\$258,500	\$258,500

Additional Information

- Prepaid rent at balance day was \$6,000.
- Wages owed were \$5,000.
- At balance day the term deposit had been held for 2 months. The term deposit pays 10% interest per annum and pays interest at the end of the term.
- The machinery is depreciated at a rate of 15% per annum using the reducing balance method.
- Further bad debts of \$500 are written off.
- The allowance for doubtful debts is to be adjusted to \$600.
- Cleaning supplies used was \$300.

Required tasks:

- a. Calculate the balance day adjustments.

Workings

Question 4

The following information has been provided by a business.

Cold Stone Yoghurt Trial Balance (extract) as at 30 June 2050		
	Debit	Credit
Capital		45,000
Cash at Bank	6,000	
Inventory	5,000	
Accounts Receivable	19,000	
Motor Vehicle	45,000	
Accumulated Depreciation of Motor Vehicle		10,000
Electricity	1,000	
Term deposit (12 months)	28,000	
Accounts Payable		3,000
Cutlery supplies	1,200	
Cost of Sales	9,000	
Loan from Bank		12,000
Sales		46,000
Discount received		500
Insurance expense	400	
Prepaid insurance	900	

Additional information:

- The one year term deposit began on 31 December 2049. Accrued interest income at balance day was \$900.
- Depreciation of motor vehicle is calculated using the straight line method. Depreciation for the previous financial year was \$4,000.
- Cutlery supplies at balance day was \$500.
- Prepaid insurance at balance day was \$200.
- Accrued electricity at balance day was \$900.
- Allowance for doubtful debts of \$1,200 was created.

Required tasks:

a. Calculate the balance day adjustments.

Workings

Question 5

Smelly House Cleaners has provided the following trial balance extract as at 30 June 2062.

Smelly House Cleaners Trial Balance (extract) as at 30 June 2062		
	Debit	Credit
Capital		
Cash at Bank	12,000	
Accounts Receivable	9,400	
Cleaning Equipment	5,000	
Accumulated Depreciation of Cleaning Equipment		1,200
Cleaning supplies	1,600	
Loan from Bank		4,000
Discount allowed	180	
Insurance expense	750	
Allowance for doubtful debts	1,100	
GST Payable		6,500
GST Credits	500	
Wages	27,500	
Bad debts	900	
Unearned Income		9,000
Fees		20,000

Additional information:

- The cleaning equipment is depreciation using the reducing balance method at a rate of 10% per annum.
- A motor vehicle was purchased for \$6,000 GST exclusive on 1 May 2062. It cost \$440 GST inclusive to transport the motor vehicle to the business. In two years, time, the motor vehicle will need to be serviced for a cost of \$300 + \$30 GST. The motor vehicle was setup and ready to use from the 1 June 2062. The motor vehicle has a useful life of 8 years and a residual value of \$2,000.
- Cleaning supplies at balance day was \$100.
- Staff are paid wages of \$1,100 fortnightly. Wages were last paid on 23 June 2062.
- Allowance for doubtful debts was to be adjusted to \$1,300.
- Unearned income at balance day was 4,000.

Required tasks:

a. Calculate the balance day adjustments.

Workings

b. Prepare the current assets and current liabilities section of the balance sheet as at 30 June 2062.

Current Assets		

Current Liabilities		

c. Complete the non-current assets section of the balance sheet as at 30 June 2062.

Non-Current Assets		

Question 6

Ghost Tunnel Tours has supplied the following information.

Ghost Tunnel Tours Trial Balance as at 30 June 2034		
	Debit	Credit
Cash at Bank	5,000	
GST Credits	500	
Unearned Income		6,000
Fees		36,000
Telephone	800	
Accounts Receivable	1,800	
Tour guide salaries	14,000	
Office rent	3,000	
Bus	42,000	
Accumulated depreciation of Bus		16,000
GST Payable		3,100
Loan from Bank		5,000
Interest expense	400	
Prepaid advertising	4,000	
Office staff wages	5,000	
Accrued selling and distribution expense		2,800
Selling and distribution expense	1,500	
Capital		20,000
Drawings	10,900	
	\$88,900	\$88,900

Additional information:

- Unearned income is \$2,000.
- Bus is depreciated using straight line method with \$3,000 depreciation expense per year.
- Depreciation straight line – mention depreciation expense is \$X per annum.
- Accrued selling and distribution expense is \$3,500.
- Advertising expense is \$3,600.
- The business categorizes expenses at tour expenses and general and administration expenses.

Required tasks:

a. Calculate the balance day adjustments.

Workings

c. Prepare the income statement for the year ended 30 June 2034.

Ghost Tunnel Tours Income Statement for the period ended 30 June 2034			
Fees			
<i>Less Other Expenses</i>			
Tour Expenses			
Advertising			
Selling and distribution expense			
Depreciation of bus			
Tour guide salaries			
General & Administration Expenses			
Office rent			
Telephone			
Office staff wages			
Interest expense			
Net Profit			

Question 7

Elite Gaming Emporium has provided the following information.

Elite Gaming Emporium Trial Balance as at 30 June 2044		
	Debit	Credit
Drawings	22,250	
Capital		45,000
Interest expense	600	
Insurance	2,000	
Advertising	4,200	
Sales		72,000
Freight Outwards	900	
Discount Allowed	700	
Loan from Bank		14,000
Accounts Receivable	12,000	
Cash at Bank	7,000	
Interest income		550
Inventory	32,000	
Accounts Payable		8,000
Prepaid rent	21,000	
Cost of Sales	23,000	
Fixtures and Fittings	6,000	
Accumulated Depreciation of Fixtures and Fittings		1,200
GST Payable		400
Bad Debts	600	
Allowance for Doubtful Debts		2,300
GST Credits	500	
Wages	10,700	
	\$143,450	\$143,450

Additional Information:

- Fixtures and fittings are depreciated at 15% per annum reducing balance method.
- Accrued interest income on balance day is \$300.
- The allowance for doubtful debts is to be set at \$2,900.
- Prepaid rent on balance day was \$4,000.

Required tasks:

a. Calculate the balance day adjustments.

Workings

Question 8

The following information has been provided by Gadgets Galore Repairs.

Gadgets Galore Repairs Trial Balance as at 30 June 2056		
	Debit	Credit
Internet	1,100	
Mobile repair expenses	4,500	
Accounts Receivable	10,000	
Repair staff wages	14,000	
Unearned Income		3,800
Fees		37,000
GST Payable		2,800
Drawings	11,300	
Office Supplies	600	
Loan from Bank		7,000
GST Credits	300	
Office Equipment	9,000	
Accumulated Depreciation of Office Equipment		2,000
Cash at Bank	4,000	
Prepaid insurance	2,000	
Insurance expense	800	
Rent	10,000	
Capital		15,000
	\$67,600	\$67,600

Additional Information

- Office equipment is depreciated using the straight line method at a rate of 8% per annum.
- Unearned income on balance day was 1,200.
- Prepaid insurance on balance day was \$500.
- Office Supplies is \$250.
- The business categorizes expenses as repair expenses and general and administration expenses.

Required tasks:

a. Calculate the balance day adjustments.

Workings

Question 9

Posture Max Furniture has supplied the following information.

Posture Max Furniture Trial Balance as at 30 June 2033		
	Debit	Credit
Drawings	10,950	
Interest expense	150	
Motor Vehicle	16,000	
Accumulated Depreciation of MV		3,000
Sales Returns	1,300	
Cash at Bank	6,000	
Inventory	14,000	
Accounts Payable		2,900
Sales		80,900
Electricity	1,800	
Insurance	500	
Loan from Bank		8,000
Freight Inwards	1,000	
Accounts receivable	7,300	
Customs Duty	200	
Prepaid advertising	3,200	
Cost of Sales	46,000	
Freight Outwards	300	
Discount Received		1,200
Cleaning Supplies	900	
Depreciation of Motor Vehicle	2,000	
Bad debts	500	
Allowance for doubtful debts		2,400
Rent	4,300	
Capital		18,000
	\$116,400	\$116,400

Additional Information

- Accrued electricity on balance day was \$300.
- Cleaning Supplies expense was \$700 on balance day.
- Prepaid advertising on balance day was \$1,800.
- Additional bad debts of \$800 are written off. The allowance for doubtful debts is adjusted to \$3,100.

Required tasks:

a. Calculate the balance day adjustments.

Workings

Question 10

The following information has been provided by Green Giant Nursey.

Green Giant Nursery Trial Balance (extract) as at 30 June 2037		
	Debit	Credit
Interest expense	190	
Capital		31,000
Drawings	13,180	
Advertising	5,400	
GST Payable		1,300
Cash at Bank	7,200	
Inventory	24,000	
GST Credits	400	
Sales		63,000
Prepaid telephone	900	
Wages	12,000	
Accounts Payable		2,700
Cost of Sales	15,000	
Office Equipment	4,300	
Accumulated Depreciation of Office Equipment		2,500
Motor Vehicle	19,000	
Accumulated Depreciation of Motor Vehicle		6,700
Accounts Receivable	7,500	
Interest Income		430
Loan from Bank		7,000
Bad debts	400	
Rent	6,000	
Allowance for Doubtful Debts		1,200
Insurance	400	

Additional information:

- An additional \$300 of bad debts are written off and the allowance for doubtful debts is adjusted to \$1,700.
- The office equipment is depreciated at a rate of 10% using the reducing balance method.
- The motor vehicle is depreciated at a rate of 15% using the reducing balance method.
- Interest income earned but not received was \$190 on balance day.
- Prepaid telephone remaining on balance day was \$250.
- Accrued wages on balance day was \$1,800.

Required tasks:

a. Calculate the balance day adjustments.

Workings

16. 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 – Syllabus

Syllabus – Unit 2	
Ratios	<p>Recording, processing and communicating financial information / Evaluating financial information for planning, coordinating, controlling and investing</p> <ul style="list-style-type: none"> • preparation and interpretation of the following ratios to evaluate the profitability and stability of a business: <ul style="list-style-type: none"> ▪ profitability ratios <ul style="list-style-type: none"> ○ profit ○ gross profit ○ expense ○ rate of return on assets ▪ liquidity ratios: <ul style="list-style-type: none"> ○ working capital formula ○ quick asset formula ▪ leverage ratio: <ul style="list-style-type: none"> ○ debt to equity formula

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 a other ratios such as, budgeted results, the results of previous years, industry averages or other businesses. This chapter also discusses some possible limitations in assessing performance from ratios and traditional financial accounting.

Ratios analysis areas and specific ratios:

- Gearing / leverage / stability:
 - Debt to Equity Ratio.
- Liquidity:
 - Working Capital Ratio / Current Ratio.
 - Quick Asset Ratio / Acid Test Ratio.
- Profitability:
 - Profit Ratio.
 - Gross Profit Ratio.
 - Expense Ratio.
 - Rate of Return on Assets Ratio.

Tips	<p><u>El Course Guide</u> 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.</p> <p><u>Rounding calculation results</u> 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.</p> <p><u>Question format</u> 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.</p>
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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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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>
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<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).
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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.

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:

- 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:

- Calculate the ratio.
 - Is this result a positive or negative indicator for the business. Note: C is a positive indicator, relative to A and B.
-
-
-
-

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.

$$\text{Debt to equity} = \frac{\text{Total liabilities}}{\text{Equity (end)}} \times 100$$

$$\begin{aligned} \text{Debt to equity ratio} &= (106,000 / 95,000) \times 100 \\ &= 111.58\% \end{aligned}$$

Step 2 – Interpret the debt to equity ratio.

When interpreting a ratio, first define the ratio.

The debt to equity ratio indicates the ability of a business to survive long term.

Next, state the ratio for each year and identify whether this has increased or decreased.

The debt to equity ratio has increased from 105.26% in 2044 to 111.58% in 2045.

The ratio is then interpreted.

The debt to equity ratio being over 100% is not ideal as this indicates high external finance reliance relative to owner's equity. There is concern that high interest rates increase debt repayments.

The debt to equity ratio increasing negatively 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 5-8: Gearing / Leverage / Stability Ratio.

$$\text{Debt to equity} = \frac{\text{Total liabilities}}{\text{Equity (end)}} \times 100$$

Question 5

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 6

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.

Question 8

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 the business has capacity to pay short term debts.

This increase is positive and may have been caused by:

- Current assets increasing relative to current liabilities.
- Decreased creditors or current liabilities.
- Cash may be idle that could be invested.
- Slower debtor receipts.

Practice Questions

Questions 9-10: Working Capital / Current Ratio.

$$\text{Working capital/current} = \frac{\text{Current assets}}{\text{Current liabilities}} \times 100$$

Question 9

Question	Current assets	Current liabilities	Working capital/current
a	\$1,400	\$900	1,400 / 900 = 155.56%
b	\$800	\$1,200	
c	\$15,000	\$23,000	
d	\$240,500	\$90,800	
e	\$950	\$430	

Question 10

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:

$$= (56,000 - 35,000 - 3,000 - 4,000) / (42,000 - 3,000) \times 100$$

$$= (14,000 / 39,000) \times 100$$

$$= 35.90\%$$

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 11-12: Quick Asset Ratio.

Questions 13-14: All Liquidity Ratios.

$$\text{Quick asset} = \frac{\text{Current assets (excluding inventory and prepayments)}}{\text{Current liabilities (excluding bank overdraft)}} \times 100$$

Question 11

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 12

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.



Gojū-no-tō, Nikko.

Practice Questions

Questions 13-14: 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 13

The following information has been provided about 'East Six Seven Ltd.'

East Six Seven Balance Sheet For the year ended 30 June 2029	
Current assets	
Cash at Bank	10,000
Accounts Receivable	6,000
Inventory	5,000
Prepaid rent	2,000
Prepaid insurance	3,000
Total current assets	26,000
Non-current assets	
Motor Vehicle	18,000
Accumulated Depreciation of Motor Vehicle	4,000
Total non-current assets	14,000
Total assets	40,000
Current liabilities	
Accounts Payable	5,000
Accrued Wages	1,500
GST Payable	600
Total current liabilities	7,100
Non-current liabilities	
Loan from Bank	12,000
Total non-current liabilities	12,000
Total liabilities	19,100
Net assets	20,900
Equity	
Capital	15,000
Add Profit	8,000
	23,000
Less Drawings	2,100
Total equity	20,900

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.
- Gross Profit ratio.
- Expense ratio.
- Rate of Return on Assets ratio.

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	<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.
				Net Sales (or Total revenue or Fees)		

Example

CX2 Construction Income Statement (extract) for the year ended 30 June 2048	
Sales	34,000
Less Cost of Sales	15,000
Gross Profit	19,000
Less Other expenses	14,000
Profit	5,000

Additional information:

- The profit ratio for 2047 was 9.27%.

Required task:

Evaluate the profit ratio for CX2 Construction.



Futarasan Shrine, Nikko.

Solution

Step 1 – Calculate the profit ratio.

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

Net sales = Sales revenue – Sales returns and allowances – Discount allowed

Note: In this question Net Sales has been provided in the question. In some questions you may need to calculate Net Sales.

$$\begin{aligned} \text{Profit} &= 5,000 / 34,000 \\ &= 14.70\% \end{aligned}$$

Step 2 – Evaluate the profit ratio.

The profit ratio indicates the profit percentage within each sale.

The profit ratio increased from 9.27% in 2047 to 14.70% in 2048.

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 NCAs due to less capital investment.
- More accrued income received.

Practice Questions

Questions 15-16: Profit Ratio.

$$\text{Profit} = \frac{\text{Profit}}{\text{Net Sales (or Total Revenue or Fees)}} \times 100$$

Net sales = Sales revenue – Sales returns and allowances – Discount allowed

Question 15

Question	Profit	Net Sales	Profit Ratio
a	\$100	\$1,000	100 / 1,000 = 10.00%
b	\$1,200	\$15,000	
c	\$23,000	\$125,000	
d	\$7,000	Net Sales: \$82,000 Discount allowed: \$2,000	
e	\$17,500	Net Sales: \$115,000 Sales returns: \$5,000	

Question 16

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.

Gross Profit Ratio

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Profitability	Ability to create profits from investment in assets or equity.	Gross Profit	Gross profit percentage within each sale.	Gross Profit	<ul style="list-style-type: none"> • Increasing gross profit relative to sales. • Lower cost of sales relative to gross profit. • Increasing profit margin. • Increasing higher profit margin sales relative to lower profit margin sales. 	<ul style="list-style-type: none"> • Decreasing gross profit relative to sales. • Higher cost of sales relative to gross profit. • Decreasing profit margin. • Increasing lower profit margin sales relative to higher profit margin sales.
				Net Sales (or Total Revenue or Fees)		

Example

Coastal Supplies Income Statement (extract) for the year ended 30 June 2036	
Sales	15,600
Less Cost of Sales	6,100
Gross Profit	9,500

Additional information:

- The gross profit ratio for 2035 was 51.92%.

Required task:

Evaluate the gross profit ratio for Coastal Supplies.

Solution

Step 1 – Calculate the gross profit ratio.

$$\text{Gross Profit} = \frac{\text{Gross Profit}}{\text{Net Sales (or Total Revenue or Fees)}} \times 100$$

$$\begin{aligned} \text{Gross Profit} &= 9,500 / 15,600 \\ &= 60.90\% \end{aligned}$$

Step 2 – Evaluate the gross profit ratio.

The gross profit ratio indicates the gross profit percentage within each sale.

The gross profit ratio increased from 51.92% in 2035 to 60.90% in 2036. This increase is positive, and the following may have occurred:

- Increasing gross profit relative to sales.
- Lower cost of sales relative to gross profit.
- Increasing profit margin.
- Increasing higher profit margin sales relative to lower profit margin sales.

Practice Questions

Questions 17-18: Gross Profit Ratio.

$$\text{Gross Profit} = \frac{\text{Gross Profit}}{\text{Net Sales (or Total Revenue or Fees)}} \times 100$$

Question 17

Question	Gross Profit	Net Sales	Gross Profit Ratio
a	\$12,000	\$19,000	= 63.16%
b	\$35,000	\$54,000	
c	\$23,000	\$46,000	
d	Sales: \$12,000 Cost of Sales: \$3,000	\$12,000	
e	Sales: \$21,000 Cost of Sales: \$9,000	\$21,000	

Question 18

Question	Gross Profit Ratio		Increasing or decreasing?
	Year 1	Year 2	
a	23.56%	32.05%	
	2037	2038	Increasing or decreasing?
b	53.12%	59.40%	
	2041	2040	Increasing or decreasing?
c	72.32%	80.43%	

d. Describe two interpretations of this ratio increasing.

e. Describe two interpretations of this ratio decreasing.

Expense Ratio

Area	Area Definition	Ratio	Ratio definition	Calculation	Interpretation – increasing	Interpretation – decreasing
Profitability	Ability to create profits from investment in assets or equity.	Expense Ratio	Expenses, except cost of sales, compared to sales.	$\frac{\text{Operating Expenses}}{\text{Net Sales (or Total Revenue or Fees)}}$	<ul style="list-style-type: none"> Increasing expenses compared to sales. Decreasing sales relative to expenses. 	<ul style="list-style-type: none"> Decreasing expenses compared to net sales. Increasing sales relative to expenses.

Example

Sun Smart Solutions Income Statement for the year ended 30 June 2044	
Sales	20,000
Less Cost of Sales	8,000
Gross Profit	12,000
Less Other Expenses	
Insurance	1,600
Wages	3,200
Rent	4,100
Profit	\$3,100

Additional information:

- The expense ratio for 2043 was 49.43%.

Required task:

Evaluate the gross profit ratio for Sun Smart Solutions.

Solution

Step 1 – Calculate the expense ratio.

The operating expenses includes all expenses except cost of sales.

$$\text{Expense} = \frac{\text{Operating Expenses}}{\text{Net Sales (or Total Revenue or Fees)}} \times 100$$

$$\begin{aligned} \text{Operating expenses} &= 1,600 + 3,200 + 4,100 \\ &= 8,900 / 20,000 \\ &= 44.50\% \end{aligned}$$

Step 2 – Evaluate the expense ratio.

The expense ratio indicates expenses, except cost of sales, compared to sales.

The expense ratio has decreased from 49.43% in 2043 to 44.50% in 2044.

This decrease is positive, and the following may have occurred:

- Decreasing expenses compared to net sales.
- Increasing sales relative to expenses.

Practice Questions

Questions 19-20: Expense Ratio.

$$\text{Expense} = \frac{\text{Operating Expenses}}{\text{Net Sales (or Total Revenue or Fees)}} \times 100$$

Question 19

Question	Operating Expenses (Expenses less Cost of Sales)	Net Sales	Expense Ratio
a	\$9,000	\$21,000	9,000 / 21,000 = 42.86%
b	\$6,400	\$18,000	
c	\$2,700	\$14,500	
d	\$12,800	\$58,000	
e	\$10,600	\$27,900	

Question 20

Question	Gross Profit Ratio		Increasing or decreasing?
	Year 1	Year 2	
a	40.50%	35.91%	
	2029	2028	Increasing or decreasing?
b	25.67%	18.21%	
	2041	2042	Increasing or decreasing?
c	43.83%	32.93%	

d. Describe two interpretations of this ratio increasing.

e. Describe two 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.	$\frac{\text{Profit}}{\text{Average total assets}}$	<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

Anime Power Ltd Trial balance (extract)		
	30 June 2035	30 June 2036
Profit	730,500	719,700
Total assets	63,000	75,000

Additional information:

- The rate of return on assets was 12.51% 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.

$$\text{Rate of Return on Assets} = \frac{\text{Profit}}{\text{Average total assets}} \times 100$$

$$\begin{aligned} \text{Rate of return on assets} &= (719,700 / 69,000) \times 100 \\ &= 10.43\% \end{aligned}$$

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 12.51% in 2035 to 10.43% 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 21-22: Rate of Return on Assets Ratio.

Practice Questions

Questions 23-24: All Profitability Ratios.

$$\text{Rate of Return on Assets} = \frac{\text{Profit}}{\text{Average total assets}} \times 100$$

Question 21

Question	Profit	Average total assets	Rate of Return on Assets
a	\$1100	\$10000	= 11.00%
b	\$550	\$3800	
c	\$4300	\$56000	
d	\$700	Total assets start of year: \$5000 Total assets end of year: \$5200	
e	\$2,100	Total assets start of year: \$12000 Total assets end of year: \$15000	

Question 22

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.

Practice Questions

Questions 23-24: All Profitability Ratios.

Question 23

The following information has been provided by Ice Cold Breeze.

Ice Cold Breeze Trial balance (extracts)		
	As at 30 June 2024	As at 30 June 2025
Profit	184,000	210,700
Revenue	313,000	325,100
Total assets	920,000	945,000

Additional Information:

- Total Assets as at 30 June 2023 was 892,000.

- Evaluate the Profit ratio for the year ended 30 June 2024 and 30 June 2025.
- Evaluate the Rate of Return on Assets for the year ended 30 June 2024 and 30 June 2025.

Workings

Question 24

The following information has been provided for Lateesha's Heataz.

Lateesha's Heataz Income Statement for the year ended 30 June 2025	
Sales	53,000
Less Cost of Sales	24,000
Gross Profit	29,000
Less Other Expenses	
Telephone	600
Wages	6,300
Insurance	2,900
Rent	3,300
Profit	\$15,900

Additional information:

- The gross profit ratio was 51.59% for the year ended 30 June 2024.
- The profit ratio was 27.92% for the year ended 30 June 2024.
- The expense ratio was 31.09% for the year ended 30 June 2024.

Required tasks:

- Evaluate the Gross Profit ratio for the year ended 30 June 2024 and 30 June 2025.
- Evaluate the Profit Ratio for the year ended 30 June 2024 and 30 June 2025.
- Evaluate the Expense Ratio for the year ended 30 June 2024 and 30 June 2025.

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	Financial reports are produced after a financial period and company position will have changed by the time financial reports are able to be analysed.
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 key performance indicators such as culture, high staff turnover etc. do not appear on financial reports 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.



Bus ride from Prague to Český Krumlov, Czechia.

Practice Questions

Questions 25-32: Ratios – Other theory.

Question 25

It is useful for internal and external users of financial reports to compare the ratios of a business with:

- a. Department averages
- b. Balance sheet averages
- c. Industry averages
- d. Previous averages

Question 26

Identify which of the following is not a limitation of ratio analysis:

- a. Ratios may highlight positive and or negative areas but will not identify causes.
- b. Data used to calculate ratios uses historical figures which are not adjusted for inflation (present value).
- c. Ratios reflect historic performance and do not predict future performance.
- d. Partial disclosure is impossible.

Question 27

A limitation of ratio analysis is timeliness. This refers to:

- a. Financial reports take a long time to prepare.
- b. The company position may have changed since reports were prepared.
- c. Ratio analysis takes a long time to complete adequately.
- d. The delay between businesses who are using ratio analysis.

Question 28

An investor is looking to diversify their portfolio to the mining sector. This investor compares ratios of two different mining companies. This is an example of comparing ratios with:

- a. Budgeted / predicted results.
- b. Previous year's results.
- c. Industry averages.
- d. Other businesses.

Question 29

List and describe three different limitations to ratio analysis.



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