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## The concept of accrual accounting

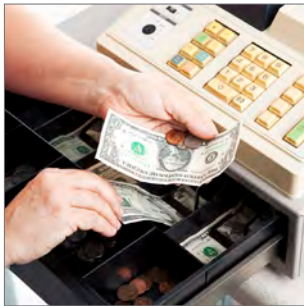
The organisation's financial performance (profits) can be measured on either a cash or an accrual basis. Most organisations use the accrual basis of accounting because this most accurately determines the organisation's performance when there are transactions that overlap from one accounting period to the next.

Here is an explanation of the two types of accounting systems.

| Cash basis   | Accrual basis  |
|--|--|
| Under the cash basis of accounting, the organisation's revenues are recorded in the accounting period when cash is received and expenses are recorded when cash is paid. Cash in this sense refers to the act of payment, not the tender, and can include credit card, cheque or barter as well as cash. | Under the accrual basis of accounting, revenues are recorded when they are earned (that is, when the business sells goods or performs services) and expenses are recorded when they are incurred in earning that revenue (that is, when goods and services are consumed). Thus, the concept of receiving or paying cash is not relevant in determining profit. |

### Example: accrual and cash accounting

Here are two examples of the way cash and rentals are managed in organisations.



Cash received from a customer may relate to services performed in the previous accounting period. Under the cash basis, this would be recorded as revenue when the cash is received, even though the services for the customer were performed in the previous period. Recording this as revenue for the current period is misleading because the business expended its energy and resources in earning the revenue during the last period, so it makes sense to record this as revenue for the previous period under the accrual basis.



An organisation may prepay a rental lease for an entire year. If profit is to be calculated halfway through the year, then only half of the rent has been consumed with the other half relating to the next accounting period. Under the accrual basis, only the rent consumed is included as an expense. However, under the cash basis, the entire rental amount paid at the start of the year is treated as an expense for the previous accounting period, even though half of this payment relates to the future. This results in a misleading and mismatched profit calculation.

## Recurring costs

Recurring costs associated with an asset are also not included in the capital cost. Recurring costs are those costs associated with the ongoing use of an asset.

Examples of recurring costs include:

- annual insurance
- registration
- repairs and maintenance.

### Example: how to calculate capital cost

Barmos Manufacturing purchased a Toyota Camry Hybrid sedan (registration BRMOS5) from Morgan Brothers Motors on 1 January 2015. Barmos Manufacturing obtained a loan from Ezy Finance for \$30,000 and paid the balance by cheque number 260269. Details of the purchase are as follows:

- Purchase price: \$38,500 (including GST)
- Dealer delivery fee: \$770 (including GST)
- Stamp duty : \$1,544
- Registration: \$425
- Insurance: \$660 (including GST)

The supply and installation of a CD stacker by Sound Plus on 1 January 2015 was paid by cheque number 260270. Cost and installation were as follows:

- CD stacker: \$495 (including GST)
- Installation of CD stacker: \$66 (including GST)

Calculation of the capital cost of the vehicle is:

| Item                       | Type of cost | Price paid<br>\$ | GST<br>\$ | Capital cost<br>\$ |
|----------------------------|--------------|------------------|-----------|--------------------|
| Purchase price             | Capital      | 38,500           | 3,500     | 35,000             |
| Dealer delivery fee        | Capital      | 770              | 70        | 700                |
| Stamp duty                 | Capital      | 1,544            | Nil       | 1,544              |
| Registration               | Recurring    | 425              | Nil       | Nil                |
| Insurance                  | Recurring    | 660              | 60        | Nil                |
| CD stacker                 | Capital      | 495              | 45        | 450                |
| Installation of CD stacker | Capital      | 66               | 6         | 60                 |
| Total capital cost         |              |                  |           | 37,754             |

To calculate the GST portion on prices that are quoted as GST inclusive, divide the cost by 11.

Using the information in the table, the asset register card for the vehicle has been completed and is shown here.

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At the end of the final year:

$\$828.35 \times 30\% = \$248.50$  depreciation expense.

| Year | Capital cost<br>\$ | Annual depreciation<br>\$ | Accumulated depreciation<br>\$ | Written-down value<br>\$ |
|------|--------------------|---------------------------|--------------------------------|--------------------------|
| 1    | 3,450              | 1,035.00                  | 1,035.00                       | 2,415.00                 |
| 2    |                    | 724.50                    | 1,759.50                       | 1,690.50                 |
| 3    |                    | 507.15                    | 2,266.65                       | 1,183.35                 |
| 4    |                    | 355.00                    | 2,621.65                       | 828.35                   |
| 5    |                    | 248.50                    | 2,870.15                       | 579.85                   |

## Pro-rata depreciation

Annual depreciation of an asset is calculated at the end of the business's financial year. If an asset is acquired or disposed of during the financial year, a pro-rata depreciation calculation is required to determine the part-year's depreciation.

### Example: pro-rata depreciation

Neutron Ltd purchased machinery on 1 October 2015 for a capital cost of \$80,000 (excluding GST). The machinery is to be depreciated at 20 per cent per annum on cost. The calculation of the pro-rata depreciation for the nine months to 30 June 2016 is as follows:

|                     |   |  |   |                       |
|---------------------|---|--|---|-----------------------|
| Capital cost        | x | Percentage depreciation rate                     | = | Annual depreciation   |
| \$80,000            | x | 20%  | = | \$16,000              |
| Annual depreciation | x | $\frac{\text{No. of months}}{12 \text{ months}}$ | = | Pro-rata depreciation |
| \$16,000            | x | $\frac{9}{12}$                                   | = | \$12,000              |

## Account for depreciation

Recording the depreciation of an asset in the accounting records is usually done at the end of the accounting period (balance day), which in Australia is generally 30 June.

A general journal entry is necessary at balance day (30 June) to:

- recognise the depreciation expense incurred in the current accounting period (this entry creates the depreciation expense for the year)
- recognise the accumulated depreciation of the asset since its purchase up to the end of the current accounting period.

## 1C

## Maintain an asset register and associated depreciation schedule

All repairs and maintenance of assets are recorded in the relevant section of the asset register card to provide a full history of the asset. The date, service provider's name, service details and cost (excluding GST) are entered so the information is up to date and easily accessible to authorised personnel.

## Example: repairs and maintenance

These repairs and maintenance were performed on the Toyota Camry Hybrid owned by Barmos Manufacturing, registration number BRMOS5.

| Date     | Particulars                          | Service provider        | Price inc. GST \$ |
|----------|--------------------------------------|-------------------------|-------------------|
| 14/2/15  | 1,500 km warranty service            | Morgan Brothers Motors  | No charge         |
| 31/3/15  | 5,000 km service                     | Morgan Brothers Motors  | 495               |
| 7/7/15   | 10,000 km service                    | Morgan Brothers Motors  | 770               |
| 18/10/15 | 15,000 km service                    | Morgan Brothers Motors  | 550               |
| 14/1/16  | 20,000 km service                    | Morgan Brothers Motors  | 847               |
| 1/3/16   | Windscreen replacement               | Clearview Windscreens   | 363               |
| 20/4/16  | 25,000 km service                    | Morgan Brothers Motors  | 539               |
| 27/6/16  | Repair electrical fault in dashboard | Lighting Auto Electrics | 418               |

The asset register card has been updated with the above information for the vehicle.

| Asset register card |                          |                          |                             |                       |                  |                |                       |
|---------------------|--------------------------|--------------------------|-----------------------------|-----------------------|------------------|----------------|-----------------------|
| Description         | Toyota Camry Hybrid      |                          |                             | Estimated residual    |                  |                |                       |
| Asset ID            | BRMOS5                   |                          |                             | Depreciation method   | Reducing-balance |                |                       |
| Location            |                          |                          |                             | Depreciation rate     | 22.5%            |                |                       |
| Supplier            | Morgan Brothers Motors   |                          |                             | Estimated useful life |                  |                |                       |
| Date                | Details                  | Original capital cost \$ | Additional capital costs \$ | Total capital cost \$ | Depreciation     |                | Written-down value \$ |
|                     |                          |                          |                             |                       | Annual \$        | Accumulated \$ |                       |
| 1/1/15              | Capital cost             | 37,244                   |                             | 37,244                | 4,248            | 4,248          |                       |
| 1/1/15              | CD stacker               |                          | 510                         | 37,754                | 7,539            | 11,787         |                       |
| 30/6/15             | Depreciation (6 months)  |                          |                             |                       |                  |                | 33,506                |
| 30/6/16             | Depreciation (12 months) |                          |                             |                       |                  |                | 25,967                |

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**Step 4: Post the journal entries to the general ledger as follows:**

| General Ledger – Barmos Manufacturing            |   |          |          |           |            |
|--|---|----------|----------|-----------|------------|
| Date   | Particulars                               | Jnl ref. | Debit \$ | Credit \$ | Balance \$ |
| <b>Motor vehicles</b>                            |   |          |          |           |            |
| 1/9/16   | Balance                                   |          |          |           | 37,754 Dr  |
|  | Disposal of motor vehicle                 | GJ       |          | 37,754    | Nil        |
| <b>Accumulated depreciation – motor vehicles</b> |   |          |          |           |            |
| 30/6/15  | Balance                                   |          |          |           | 11,787 Cr  |
| 1/9/16   | Depreciation – motor vehicles             | GJ       |          | 974       | 12,761 Cr  |
|  | Disposal of motor vehicle                 | GJ       | 12,761   |           | Nil        |
| <b>Depreciation expense – motor vehicles</b>     |   |          |          |           |            |
| 1/9/16   | Accumulated depreciation – motor vehicles | GJ       | 974      |           | 974 Dr     |
| <b>Disposal of motor vehicle</b>                 |   |          |          |           |            |
| 1/9/16   | Motor vehicles                            |          | 37,754   |           | 37,754 Dr  |
|  | Accumulated depreciation – motor vehicles | GJ       |          | 12,761    | 24,993 Dr  |
|  | Sundry debtor – Outdoor Escapades         | GJ       |          | 25,000    | 7 Cr       |
|  | Profit on disposal of motor vehicles      | GJ       | 7        |           | Nil        |
|  | GST payable – motor vehicle               |          |          | 2,500     | 2,500 CR   |
| <b>Profit on disposal of motor vehicle</b>       |   |          |          |           |            |
| 1/9/16   | Disposal of motor vehicle                 | GJ       |          | 7         | 7 Cr       |
| <b>Sundry debtor – Outdoor Escapades</b>         |   |          |          |           |            |
| 1/9/16   | Disposal of motor vehicle and GST payable | GJ       | 27,500   |           | 27,500 Dr  |

## Learning checkpoint 1

### Maintain an asset register

This learning checkpoint allows you to review your skills and knowledge in maintaining an asset register. Templates for the accountancy tables are available at <http://chilp.it/ee80e58> or by scanning the QR code.



#### Part A

Explain the difference between current and non-current assets, giving four examples of each.

#### Part B

Read the case study, then complete the tasks that follow. All calculations should be rounded to the nearest dollar.

##### Case study

A motor vehicle was purchased on 30 April 2013 for \$30,600 (excluding GST). Twelve months' registration, costing \$500, was included in the purchase price.

Prior to delivery, the vehicle was converted to dual-fuel with the supply and installation of an LPG tank. The cost of the conversion was \$2,090 (including GST).

The motor vehicle is to be depreciated at a rate of 25 per cent per annum reducing-balance method.

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| General journal |  |       |             |              |
|-----------------|--|-------|-------------|--------------|
| Date            | Particulars                                    | Folio | Debit<br>\$ | Credit<br>\$ |
| 30/6/16         | Salaries and wages expense                     |       | 1,000       |              |
|                 | Accrued expenses                               |       |             | 1,000        |
|                 | <i>Wages owing but not paid at balance day</i> |       |             |              |

The balance for the salaries and wages expense account would now be \$36,000 (\$35,000 + \$1,000), being the correct salaries and wages expense for the current accounting period. This adjusted amount will then be transferred to a profit and loss account.

The accrued expenses account will appear as a current liability in the current period's statement of financial position, as it represents a short-term liability that will be paid early in the next accounting period.

The general ledger accounts, after the adjusting entry above has been posted, will be as follows.

| General ledger                    |                                 |             |             |              |               |
|-----------------------------------|---------------------------------|-------------|-------------|--------------|---------------|
| Date                              | Particulars                     | Jnl<br>ref. | Debit<br>\$ | Credit<br>\$ | Balance<br>\$ |
| <b>Salaries and wages expense</b> |                                 |             |             |              |               |
| 30/6/16                           | Balance (wages paid to 27/6/15) |             |             |              | 35,000 Dr     |
|                                   | Accrued expenses                | GJ          | 1,000       |              | 36,000 Dr     |
| <b>Accrued expenses</b>           |                                 |             |             |              |               |
| 30/6/16                           | Salaries and wages expense      | GJ          |             | 1,000        | 1,000 Cr      |

## Prepaid expenses

Prepaid expenses are expenses that have been paid in the current accounting period but relate to the next financial year. This results in an overstatement of expenses for the current period as the payment of the expenses will be recorded in the current period. For example, insurance is an expense that is often paid in advance.



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| General ledger               |                           |          |          |           |            |
|------------------------------|---------------------------|----------|----------|-----------|------------|
| Date                         | Particulars               | Jnl ref. | Debit \$ | Credit \$ | Balance \$ |
| <b>Bad debts</b>             |                           |          |          |           |            |
| 15/9/15                      | Trade debtors control     | GJ       | 500      |           | 500 Dr     |
| <b>GST payable</b>           |                           |          |          |           |            |
| 15/9/15                      | Balance                   |          |          |           | 1,200 Cr   |
|                              | Trade debtors control     | GJ       | 50       |           | 1,150 Cr   |
| <b>Trade debtors control</b> |                           |          |          |           |            |
| 15/9/15                      | Balance                   |          |          |           | 8,000 Dr   |
|                              | Bad debts and GST payable | GJ       |          | 550       | 7,450 Dr   |

## Doubtful debts

Remember that your aim is to measure, as accurately as possible, the profit or loss earned by your organisation during an accounting period. In order to do this you must match, as closely as possible, the revenue earned during the period with the associated expenses of that period.

When goods are sold on credit, there is always the risk of the debtor not paying the amount due. This may not become evident until a later accounting period. Therefore, the bad debt expense would not be matched with the revenue earned in the accounting period in which the original sale occurred.

It is standard practice to estimate the value of debts that are unlikely to be collected in the future from credit sales made in the current accounting period. This estimate is referred to as 'doubtful debts' and is recorded as an expense in the current accounting period to be matched against the revenue earned from the sale in that period.



## 2D

## Adjust ledger accounts for inventories and leave at balance day

Trading stock, sometimes referred to as inventory, consists of the goods an organisation buys from suppliers and sells to its customers. On balance day, the organisation performs a manual stocktake to ascertain the value of the trading stock that is on hand and available for sale in the next accounting period.

Purchases of trading goods are recorded in the purchases expense account. In accordance with the accrual accounting concept, purchases are recognised in the period in which they are incurred. At the end of the accounting period, the organisation may still have some of these trading goods in stock. In other words, the organisation now has an unused purchases expense for this accounting period.

Those goods still in stock will be sold in the next accounting period so the expense should be identified and recorded in the next accounting period.

For the current accounting period, you may expect that the purchases expense will be reduced by the value of the items still in stock to accurately reflect the actual expense incurred. Although this is in principle correct, it is common accounting practice to record this unused expense in an account called the trading account. By using this account you will, in effect, be indirectly reducing the purchases expense.

## Example: trading stock

At balance day, as a result of a stocktake, it was established that there was \$3,000 worth of trading stock on hand (unsold).

An adjustment is necessary at balance day (30 June 2016) to:

- record the unsold stock in an asset account called stock or inventory
- record the reduction in purchases expense through the trading account.

| General journal |   |       |          |           |
|-----------------|---|-------|----------|-----------|
| Date            | Particulars                                   | Folio | Debit \$ | Credit \$ |
| 30/6/16         | Stock   |       | 3,000    |           |
|                 | Trading                                       |       |          | 3,000     |
|                 | <i>Record closing stock as at balance day</i> |       |          |           |

The general ledger accounts, after the adjusting entry above has been posted, will be as follows.

| General ledger |             |          |          |           |            |
|----------------|-------------|----------|----------|-----------|------------|
| Date           | Particulars | Jnl ref. | Debit \$ | Credit \$ | Balance \$ |
| <b>Stock</b>   |             |          |          |           |            |
| 30/6/16        | Trading     | GJ       | 3,000    |           | 3,000 Dr   |
| <b>Trading</b> |             |          |          |           |            |
| 30/6/16        | Stock       | GJ       |          | 3,000     | 3,000 Cr   |

### **Revenues**

Revenues arise when an organisation makes a sale or provides a service to a customer.

### **Expenses**

An organisation incurs expenses for items such as wages and salaries, advertising, stationery, motor vehicles, equipment, machinery and payments for utilities.

## **Debit and credit entries**

Customers or debtors who owe the organisation money are classified as assets. As a result, when posting transactions from the journals to each debtor's account:

- an entry recorded in the debit column will increase the amount owing by the debtor
- an entry recorded in the credit column will decrease the amount owing by the debtor.

Here are the account classifications and the double-entry accounting rules to record increases and decreases in these accounts.

### **Asset accounts**

To increase an asset account, record the amount in the debit column.  
To decrease an asset account, record the amount in the credit column.

### **Liability accounts**

To increase a liability account, record the amount in the credit column.  
To decrease a liability account, record the amount in the debit column.

### **Owner's equity accounts**

To increase an owner's equity account, record the amount in the credit column.  
To decrease an owner's equity account, record the amount in the debit column.

# 3A

## Understand the trading account

There is a difference between businesses that trade in stock and those that sell services. Here is an explanation of how these businesses run and how they are different.

### Business that buys, marks up and on-sells stock

- Enters general journal entries for closing revenue, expense and stock account balances
- Posts revenue, expense and stock account balances to the trading account and profit and loss accounts
- Determines gross and net profits
- Closes accounts to the capital account

### Business that provides a service

- Enters general journal entries for closing revenue, expense and supplies account balances
- Posts revenue, expense and supplies account balances to the cost of supplies account and profit and loss accounts
- Determines cost of supplies and net profits
- Closes accounts to the capital account

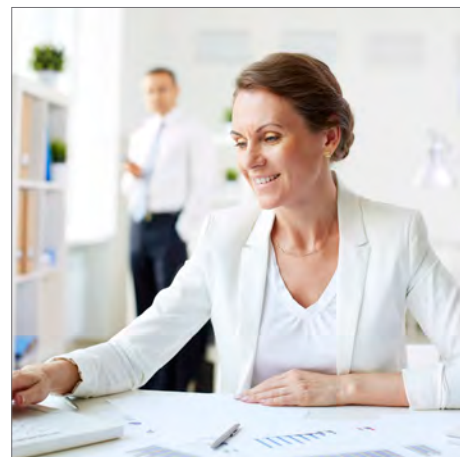
## The trading account

The trading account is used by organisations that buy and sell goods or trading organisations. The purpose of the trading account is to determine the organisation's gross profit or gross loss. The trading result is calculated by deducting the cost of purchasing the goods and getting them ready for sale, from the revenue earned from selling the goods; that is:

$$\text{Trading revenue} - \text{Cost of goods sold} = \text{Gross profit/loss}$$

The gross profit must be sufficient to cover the other operating costs of the organisation to return a net profit.

The information in the trading account is used for the preparation of the income (profit and loss) statement.



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| Date           | Particulars                      | Jnl ref. | Debit \$ | Credit \$ | Balance \$ |
|----------------|----------------------------------|----------|----------|-----------|------------|
| <b>Trading</b> |                                  |          |          |           |            |
| 30/6/16        | Stock (opening stock 1/7/15)     |          | 3,500    |           | 3,500 Dr   |
|                | Stock (closing stock 30/6/16)    |          |          | 2,800     | 700 Dr     |
|                | Sales returns and allowances     | GJ       | 2,000    |           | 2,700 Dr   |
|                | Purchases                        | GJ       | 21,000   |           | 23,700 Dr  |
|                | Freight inwards                  | GJ       | 1,500    |           | 25,200 Dr  |
|                | Insurance on stock               | GJ       | 1,200    |           | 26,400 Dr  |
|                | Customs duty                     | GJ       | 1,300    |           | 27,700 Dr  |
|                | Wharfage fees                    | GJ       | 900      |           | 28,600 Dr  |
|                | Sales                            | GJ       |          | 64,000    | 35,400 Cr  |
|                | Purchases returns and allowances | GJ       |          | 1,000     | 36,400 Cr  |

All of the trading revenue and cost of goods sold expense accounts now have a nil balance.

- The stock account has a debit balance of \$2,800 representing the value of the unsold stock (unused purchases expense) to be sold in the next accounting period and is shown as an asset on the statement of financial position.
- The trading account has a credit balance of \$36,400. This represents the difference between the trading revenue and the cost of goods sold (gross profit).

## Gross profit or loss

After all the trading revenue and cost of goods sold expense account balances have been transferred to the trading account, the remaining balance represents either:

- a gross profit (if a credit balance)
- a gross loss (if a debit balance).

A gross profit results when the trading revenue earned is greater than the total of all the cost of goods sold expenses – total credits exceed total debits.

A gross loss results when the total of the cost of goods sold expenses is greater than the trading revenue earned – total debits exceed total credits.

Because the trading account is a temporary or clearing account, the balance remaining in the account (gross profit/loss) must be closed to a nil balance. To do this, the gross profit/loss is transferred to another temporary or clearing account called the profit and loss account to determine the overall net profit or loss for the accounting period.



... continued

| General ledger                         |                 |          |          |           |            |
|--|-----------------|----------|----------|-----------|------------|
| Date                                   | Particulars     | Jnl ref. | Debit \$ | Credit \$ | Balance \$ |
| <b>Rent</b>                            |                 |          |          |           |            |
| 30/6/16                                | Balance         |          |          |           | 5,200 Dr   |
|  | Profit and loss | GJ       |          | 5,200     | Nil        |
| <b>Freight outwards</b>                |                 |          |          |           |            |
| 30/6/16                                | Balance         |          |          |           | 308 Dr     |
|  | Profit and loss | GJ       |          | 308       | Nil        |
| <b>Discount allowed</b>                |                 |          |          |           |            |
| 30/6/16                                | Balance         |          |          |           | 260 Dr     |
|  | Profit and loss | GJ       |          | 260       | Nil        |
| <b>Stationery</b>                      |                 |          |          |           |            |
| 30/6/16                                | Balance         |          |          |           | 315 Dr     |
|  | Profit and loss | GJ       |          | 315       | Nil        |
| <b>Depreciation – motor vehicle</b>    |                 |          |          |           |            |
| 30/6/16                                | Balance         |          |          |           | 1,350 Dr   |
|  | Profit and loss | GJ       |          | 1,350     | Nil        |
| <b>Depreciation – shop fittings</b>    |                 |          |          |           |            |
| 30/6/16                                | Balance         |          |          |           | 250 Dr     |
|  | Profit and loss | GJ       |          | 250       | Nil        |
| <b>Depreciation – office equipment</b> |                 |          |          |           |            |
| 30/6/16                                | Balance         |          |          |           | 800 Dr     |
|  | Profit and loss | GJ       |          | 800       | Nil        |
| <b>Advertising</b>                     |                 |          |          |           |            |
| 30/6/16                                | Balance         |          |          |           | 2,407 Dr   |
|  | Profit and loss | GJ       |          | 2,407     | Nil        |
| <b>Motor vehicle expenses</b>          |                 |          |          |           |            |
| 30/6/16                                | Balance         |          |          |           | 3,604 Dr   |
|  | Profit and loss | GJ       |          | 3,604     | Nil        |
| <b>Wages</b>                           |                 |          |          |           |            |
| 30/6/16                                | Balance         |          |          |           | 8,400 Dr   |
|  | Profit and loss | GJ       |          | 8,400     | Nil        |

continued ...

## Practice task 10

Templates for practice tasks for this topic can be found at <http://chilp.it/ee80e58> or by scanning the QR code. Keep your solutions to this practice task as you will use them for later practice tasks.

During the year ended 30 June 2015, Billy Bob, owner of BB's Disposals, withdrew \$6,000 from the business. Prepare and post the general journal entry to close the drawings account. Post these general journal entries to the relevant general ledger accounts.

You may need to use information from your answers to practice tasks 8 and 9.



... continued

|  |                         |    |       |        |           |
|--|-------------------------|----|-------|--------|-----------|
|  | Staff amenities         | GJ | 360   |        | 55,178 Dr |
|  | Interest on loan        | GJ | 1,500 |        | 56,678 Dr |
|  | Rates                   | GJ | 842   |        | 57,520 Dr |
|  | Accounting expenses     | GJ | 600   |        | 58,120 Dr |
|  | Electrical fees revenue | GJ |       | 64,000 | 5,880 Cr  |
|  | Discount received       | GJ |       | 180    | 6,606 Cr  |

All other revenue and expense accounts will now have a nil balance. The profit and loss account and the drawings account are now closed to the capital account.

| General journal – Sparky Electronics |                                    |       |          |           |
|--------------------------------------|------------------------------------|-------|----------|-----------|
| Date                                 | Particulars                        | Folio | Debit \$ | Credit \$ |
| 30/6/16                              | Profit and loss                    |       | 6,060    |           |
|                                      | Capital                            |       |          | 6,060     |
|                                      | <i>Close net profit to capital</i> |       |          |           |
| 30/6/16                              | Capital                            |       | 18,000   |           |
|                                      | Drawings                           |       |          | 18,000    |
|                                      | <i>Close drawings to capital</i>   |       |          |           |

The general ledger accounts, after the entries above have been posted, will be as follows.

| General ledger – Sparky Electronics |                                  |          |          |           |            |
|-------------------------------------|----------------------------------|----------|----------|-----------|------------|
| Date                                | Particulars                      | Jnl ref. | Debit \$ | Credit \$ | Balance \$ |
| <b>Profit and loss</b>              |                                  |          |          |           |            |
| 30/6/16                             | Cost of electrical supplies used | GJ       | 20,300   |           | 20,300 Dr  |
|                                     | Rent                             | GJ       | 5,200    |           | 25,500 Dr  |
|                                     | Discount allowed                 | GJ       | 260      |           | 25,760 Dr  |
|                                     | Stationery                       | GJ       | 315      |           | 26,075 Dr  |
|                                     | Depreciation – motor vehicle     | GJ       | 4,500    |           | 30,575 Dr  |
|                                     | Depreciation – tools             | GJ       | 4,200    |           | 34,775 Dr  |
|                                     | Depreciation – office equipment  | GJ       | 800      |           | 35,575 Dr  |
|                                     | Advertising                      | GJ       | 2,407    |           | 37,982 Dr  |
|                                     | Motor vehicle expense            | GJ       | 3,604    |           | 41,586 Dr  |

continued ...



## 4A

## Prepare the income (profit and loss) statement

The income statement, commonly referred to as the profit and loss statement, reports on the revenues and expenses for the year and has the following features.

### Title

The title of the statement must show the organisation's name and the accounting period for which the statement is being prepared; for example, for the year ending or for the months ending.

### Trading section

All revenues and expenses shown in the general ledger trading account are reported in the trading section of the statement to show the organisation's gross profit or loss.

### Profit and loss section

All revenues and expenses shown in the general ledger profit and loss account are included in the statement to show the organisation's net profit or loss.

## 4B

## Prepare the statement of financial position (balance sheet)

The statement of financial position is a listing of the organisation's assets, liabilities and owner's equity balances and is presented in a format that is similar to the accounting equation:

$$\text{Owner's equity} = \text{assets} - \text{liabilities}$$

The statement of financial position has the following features.

### Title

The title of the statement must show the name of the organisation and the date at which the statement has been prepared; for example, as at 30 June 2016. The words 'as at' must be used, as the statement of financial position shows the account balances at a particular date, unlike an income statement, which shows the profit (loss) over a period of time.

### Owner's equity

The full details of the amounts owing to and taken by the owner must be reported, hence the opening balance, drawings and net profit/loss are listed as shown in the general ledger capital account.

### Working capital

Working capital is the term used to refer to the organisation's liquidity. This is the organisation's ability to meet its current liabilities from current assets available. The balances of all the current asset and current liability general ledger accounts are listed. The difference between the total of current assets and current liabilities represents working capital.

### Current assets

Current assets are assets that are either cash or convertible to cash within the ensuing 12 months. Examples of current assets include cash at bank, input tax credits, debtors, stock, prepaid expenses and accrued revenue. Provision for doubtful debts is also included, as it is a negative current asset that is deducted from debtors to determine a net debtor's balance.

### Current liabilities

Current liabilities are liabilities that are expected to be repaid within the ensuing 12 months. Examples of current liabilities include creditors, GST payable, accrued expenses, prepaid revenues and provision for annual leave.

## Summary

1. At the end of the year, after all closing procedures have been finalised, it is necessary to prepare the two main financial reports – the income (profit and loss) statement and the statement of financial position.
2. The income statement, commonly referred to as the profit and loss statement, reports on the revenues and expenses for the year. All revenues and expenses shown in the general ledger trading account are reported in the trading section of the income statement to show the organisation's gross profit or loss. All revenues and expenses shown in the general ledger profit and loss account are included in the income statement to show the organisation's net profit or loss.
3. The statement of financial position is a listing of the organisation's assets, liabilities and owner's equity balances. The statement of financial position shows the account balances 'as at' a particular date, unlike an income statement, which shows the profit over a period of time. The full details of the amounts owing to and taken by the owner must be reported in the statement of financial position – hence, the opening balance, drawings and net profit/loss are listed as shown in the general ledger capital account.
4. The difference between the total of current assets and current liabilities represents working capital. Working capital is the term used to refer to the organisation's liquidity. This is the ability of the organisation to meet its current liabilities from current assets available. Current assets are assets that are either cash, or convertible to cash within the ensuing 12 months. Examples of current assets include cash at bank, input tax credits, debtors, stock, prepaid expenses and accrued revenue. Current liabilities are liabilities that are expected to be repaid within the ensuing 12 months. Examples of current liabilities include creditors, GST payable, accrued expenses, prepaid revenues and provision for annual leave.
5. Net assets represents the final balance of all assets less all liabilities and should equal the owner's equity balance.
6. Non-current assets are assets that will be held for longer than 12 months and are used by the business for generating revenue in the future. Examples of non-current assets include land, buildings and motor vehicles.
7. Deferred (non-current) liabilities are liabilities that are unlikely to be repaid within the next 12 months. Examples of deferred liabilities include mortgages on land and buildings, loans (due in over a year) and provision for long service leave.

... continued

| Date           | Particulars          | Jnl ref. | Debit \$ | Credit \$ | Balance \$ |
|----------------|----------------------|----------|----------|-----------|------------|
|                | Annual leave expense |          | 700      |           | 2,775 Dr   |
|                | Commission revenue   |          |          | 425       | 2,350 Dr   |
|                | Capital              |          |          | 2,350     | Nil        |
| <b>Capital</b> |                      |          |          |           |            |
| 30/6/16        | Balance              |          |          |           | 34,026 Cr  |
|                | Profit and loss      |          | 2,350    |           | 31,676 Cr  |
|                | Drawings             |          | 740      |           | 30,936 Cr  |

| Sammy's Bric-a-Brac<br>Post-closing trial balance as at 30 June 2016 |               |               |
|--|---------------|---------------|
| Account name   | Debit \$      | Credit \$     |
| Bank   |               | 621           |
| Trade debtors control  | 1,500         |               |
| Trade creditors control  |               | 905           |
| Input tax credits  | 126           |               |
| GST payable  |               | 79            |
| Land and buildings   | 50,000        |               |
| Mortgage on land and buildings                                       |               | 32,000        |
| Petty cash   | 150           |               |
| Stock (30/6/16)  | 3,200         |               |
| Capital  |               | 30,936        |
| Motor vehicle  | 15,000        |               |
| Accumulated depreciation – motor vehicle                             |               | 5,000         |
| Furniture and fixtures   | 700           |               |
| Prepaid expenses   | 35            |               |
| Accrued revenue  | 125           |               |
| Accrued expenses   |               | 560           |
| Accumulated depreciation – furniture and fixtures                    |               | 35            |
| Provision for annual leave   |               | 700           |
|  | <b>70,836</b> | <b>70,836</b> |