ACCOUNTING AND FINANCIAL PROCESSES

TTM: New Zealand Diploma in Tourism and Travel
Level 5

TRAINER RESOURCE for NZST Online

NZQA VERSION 2
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TABLE OF CONTENTS

INTRODUCTION

This component serves as an introduction to accounting principles and is quite practical in nature, i.e. manual bookkeeping. You will have the opportunity to practice through many exercises and experience what it is like to be responsible for finances.

What is accounting?

To "account" for something means to give a justifying analysis or explanation (Merriam Webster dictionary). Therefore, 'financial accounting' is the explanation of financial events.

- What happened
- When it happened
- Why it happened
- What were the consequences

We call financial events 'transactions'

THE FUNCTION AND PURPOSE OF ACCOUNTING

Tourism is a business. Businesses only make money if they are managed correctly, and a large part of that management is behind the scenes – management need to make sure that the company's processes are as efficient as possible in terms of knowing where all the money is being spent.

For this reason, it is important to be able to understand the nature of accounting and accounting concepts, explain and classify transactions according to their effect on the expanded accounting equation, and prepare financial statements as part of the business process of tourism.

The function of accounting is to:

Collect and record data
Classify and summarise data
Communicate what has been learned from the data

The purpose of accounting is to enable users to make business decisions.

THE USERS OF ACCOUNTING

The information prepared by the accountant is made available to people who have an interest in the business. These people are called stakeholders. The type of information provided by the accountant depends on the individual needs of these stakeholders.

User Types include:

- Directors / Owners
- Shareholders & Stakeholders (Other stakeholders)
- Management
- Potential investors
- Creditors (someone we owe money to)
- Government
- The general public

1. What type of information do you think each user needs?

   Answers may vary depending on the type/choice of user

2. What will they use this information for?

   Answers may vary depending on the type/choice of user

3. Think about which stakeholder group/s would be most interested in the following:
   a. The GST and other tax liabilities of the business?

      Government

   b. The potential for pay awards and bonuses?

      Managers / Directors

   c. The ethical or environmental activities of the firm?

      The General Public, Management and/or Directors

   d. The long-term future of the business?

      Directors / Owners / Shareholders / Stakeholders / Creditors / Potential Investors

e. The profitability and share performance of the business?

Directors / Owners / Shareholders / Stakeholders / Potential Investors

f. The ability of the business to carry on providing a service or producing a product?

Directors / Owners / Shareholders / Stakeholders / Potential Investors / Management

INTERNAL USERS

Why do certain internal users need this information? Identify the information needs of the following

Directors / Owners / Shareholders

The owner provides the initial funds (capital) into the business, so they are interested in the return on their funds and also, the financial stability of the business. Therefore, they need information on how much the business has earned (profits) and if it can pay its bills when they are due.

MANAGERS

There are different levels of managers, and each manager will need different information.

Senior management

want information that shows how their policy decisions have affected the business performance. This enables them to make new policy decisions for the future. Or similar

Middle management

wants information on the performance of their individual departments (marketing, finance, production etc) and how effective and efficient they have been in carrying out the policy decisions of top management.

Junior management

wants information to see how their individual segments are performing. Lower management have decisions to make in the day to day running of the business. They will be looking at current staff management (should they increase/decrease staff), budgetary comparisons (how to reduce expenditure/increase revenue), controlling assets and liabilities. They need both 'segmented' and 'total' information to see how they fit into the overall picture.

Employees

Workers are concerned about the performance of the business and its future prospects as they want to know about their future job security. They will also be interested in this information so that they can assess the ability of the business to pay salaries, retirement benefits, and if there is a potential for salary increases in the future.

EXTERNAL USERS

Why do certain external users need this information?

Creditors

These people/suppliers provide goods and services to the business so they are concerned about the financial stability of the business and whether it can pay its bills on time. They will focus on the liquidity of the business.

Lenders

Financial Institutions such as banks will need information in the financial stability of the business so as to assess whether the business will be able to pay back their loans and interest when it is due and also to decide whether to lend more money to the business in the future.

Potential Investors

These are people who are considering investing in the business (buying shares). They will need information on financial stability and return on investment. Of course, they will also want to know about profitability and measures of performance management. They will use all this information to help them decide whether or not to invest in the business.

Governments and their agencies

IRD; the taxation department, will be interested to see the profit of the business and how the business values their assets and the allocation of resources, for tax purposes. Statistics NZ will be interested in various data such as sales levels, profits, investments and so on. This information is used in setting policies for managing the economy.

Customers

Customers are concerned with the viability of a business, especially when they have a long-term involvement with, or are dependent on, the business for its products.

The General Public & Other Interested Parties

People in local community may use financial statements to get information about the trends/recent developments in the prosperity of the business and the range of its activities as they affect their area. Neighbouring businesses, competitors, etc, might want information on excessive profits, overseas ownership and so on.
The general public will also be interested in how well the business is using its resources and what it is doing to maintain the quality of life in relation to pollution control, recycling and replacement of resources.

HANDOUT RECAP 1

1. The function of accounting is to:
    a. Collect and record data
    b. Classify and summarise data
    c. Communicate what has been learned from the data
    d. All of the above

2. The purpose of accounting is to:
    a. Collect and record data
    b. Enable users to make business decisions
    c. Classify and summarise data
    d. Communicate what has been learned from the data
    e. None of the above

3. People who have an interest in the financial affairs of a business are called:
    a. Shareholders
    b. Stakeholders
    c. Cardholders

4. Directors / owners / shareholders are mostly interested in:
    d. The tax liabilities of the business
    e. The profit of the business
    f. The potential for a pay bonus
    g. The environmental activities of the business

5. Management are mostly interested in:
    a. The profit of the business
    b. The ability of the business to pay back its loans
    c. The environmental activities of the business
    d. The performance of individual departments

6. Potential investors are mostly interested in:
    e. The potential for a pay bonus
    f. The environmental activities of the business
    g. The profitability of the business and the return on investment
    h. The performance of individual departments

7. Creditors are mostly interested in:
    a. The tax liabilities of the business
    b. The ability of the business to pay its bills
    a. The ability of the business to pay back its loans
    b. The profitability of the business and the return on investment

8. Lenders are mostly interested in:
    a. The ability of the business to pay its bills
    b. The ability of the business to pay back its loans
    c. The profitability of the business and the return on investment
    d. The performance of individual departments

9. Customers are mostly interest in
    a. The profit of the business
    b. The performance of individual departments
    c. The ability of the business to continue to provide goods and service in the future
    d. The tax liabilities of the business

10. The government is mostly interested in:
    a. The profit of the business
    b. The tax liabilities of the business
    c. The ability of the business to pay its bills
    d. The performance of individual departments

11. The general public is mostly interested in:
    a. The tax liabilities of the business
    b. The profit of the business
    c. The environmental activities of the business
    d. The performance of individual departments

Check your score: ______ out of 11

CONCEPTS OF ACCOUNTING

The Concepts of Accounting

The Chartered Accountants Australia & New Zealand published the NZ Framework. It gives a set of fundamental principles to help people prepare financial reports. These fundamental principles are based on keywords and phrases that best describe the basic ideas on which accounting are based. These ideas are called **concepts**. In other words, the concepts of accounting are a set of basic ideas on how accounting standards and reports should be prepared.

Imagine you own a business, and you give a set of your accounting records to five different accountants. You ask them to calculate your profit for the year. Each of the five accountants comes up with a different profit figure; which one is correct?

To prevent this from happening, a 'set of rules' or an 'accepted way of doing accounting' has been developed, i.e. **the concepts of accounting**.

Put students in 8 groups to read and present one of the above topics to the class. The information is found over the next few pages. Allow them to use the white board and coloured markers. This will make the topic more interesting as otherwise you will just be reading a lot of text to them. Then debrief each one to reinforce the information.

ENTITY

An entity is described as "something that has separate and distinct existence" to something else. In our case this would be the business.

The financial affairs of the business should be kept separate from the financial affairs of the owner(s). The business is treated as a separate 'entity'.

For example: Bob is a sole trader

- He buys a new van for work – this is a business transaction and should be recorded in the accounting system
- He buys a new car for his family – this is a personal transaction and should not be recorded in the accounting system

It is important to keep the business and personal affairs separate for the following reasons:

- Correct calculation of taxes
- Valuation of the business for sale purposes
- The raising of finance
- The calculation of profits
- Ensuring private funds do not get spent in the business and vice versa

In New Zealand there are different types of legal entities. The main types are;

- **Sole Trader** – this is where the owner operates the business in his or her own name. The owner will have very little legal protection of their private assets if things go wrong. The business can have a different trading name. (A builder, or a Dairy Owner etc.,)
- **Partnership** – where two or more owners operate the same business together. Again, the owners would have very little legal protection of their private assets. (Two or more sole traders)
- **Company** – a company is a separate legal entity with 'Ltd' or 'Limited' after the name. The business can have a different trading name. There is a lot more legal compliance but there is some legal protection for the owner.
- **Trust** – this is a separate legal entity which again has a high compliance cost. It provides a lot of protection for the 'beneficiary' of the Trust.

GOING CONCERN

The business (entity) will continue to operate as normal for the foreseeable future. It is assumed that there is no intention or need to stop the business from operating. As a result, the financial statements are prepared in a certain way.

For example, the expected selling price is not relevant when valuing assets (such as vehicles and machinery) in the balance sheet (we will study this in detail later) because there is no plan to sell them now; the business is not closing down, and these assets are expected to provide future economic benefits.

If the business was not going to operate as normal, i.e. if it was going to be sold or closed down then this assumption would not apply. As a result, the financial statements would be prepared in a different way. The going concern assumption is not very useful when it comes to measuring the results of the business activities and making business decisions.

ACCOUNTING PERIOD

Users of accounting need information on a regular basis, so, for this reason, the business activities are divided into set 'periods', usually of equal length of time and reports are prepared for that period.

The length of time for which the accounting information is prepared is called the accounting period. The accounting period can vary from business to business; however, it should be at regular intervals (every month, quarter [3months], half year or year).

MONETARY

All transactions are measured in a common monetary unit (currency) and only events that can be recorded in monetary units are reported in the financial statements. In the case of New Zealand, we record all transactions in New Zealand dollars (NZD).

For example, if Bob has a work van and Roger has two work vans, who has the most assets? We must calculate the value of each van in dollars and then make the comparison.

HISTORICAL COST

All transactions are recorded at their actual (original) cost to the entity. For example, every year Bob records the value of his work van as the price he originally paid for it on the day he bought it, not today's market value. Technically, the van is not worth as much today because it has been used and is older. To account for this loss in value we use a concept called 'depreciation' (we will study this later).

ACCRUALS BASIS

Transactions are recorded in the period in which they physically occur, not when the money is actually exchanged (received or paid). Accrual accounting attempts to record the financial effects of transactions relating to the accounting periods for which those transactions occur. Financial statements are prepared using accrual accounting.

ACCRUAL ACCOUNTING

ACCRUAL ACCOUNTING INVOLVES:

- Recording revenue when it is earned and expenses when they are incurred
  and
- Adjusting the accounts so as to ensure that transactions are identified appropriately, according to the specific accounting period

For example, if Bob buys a new work van in March, on credit, even though he doesn't actually pay for it at the time, he will still record this transaction (purchase) in the March period. Similarly, if Bob makes a sale in April but does not actually receive the money at the time, he will still record this transaction (sale) in the April period.

PLEASE NOTE:
The day the invoice is given is the day you put it in the books for that month.

The month you pay for an item/service, is when it goes in, not when you get/use it

QUALITATIVE CHARACTERISTICS

The quality of the information produced as a result of accounting will determine how useful it is to the users.

The components of the qualitative characteristics are:

RELEVANCE

Information is relevant when it helps users to evaluate past, present and future events by confirming or correcting their past evaluations.

To be relevant, accounting information must enable users to

- Make their own predictions about the economic viability of the entity
  or
- Assess predictions and assurances given by management as to the future success or otherwise, of the entity
  or
- Confirm past events and evaluations, i.e. give feedback on the outcome of earlier predictions on which the entity's management had based its decisions

The relevance of information is also affected by the time in which it was produced. If the information is not available when it is needed, or it becomes available after it is needed, then it lacks relevance. Timeliness does not make information relevant, but the lack of timeliness can remove relevance from information. Viability = how well they're doing.

UNDERSTANDABILITY

Accountants must prepare the information in a way that is easy for the users to understand.

Information should be clearly explained and presented. Where necessary, the information should be in a summarised form that takes into account the intended reader/user.

However, users are assumed to have reasonable knowledge of business, economic activities and accounting. If they do not understand accounting information that is properly presented, then it is presumed that they would hire an expert to help them.

RELIABLE

To be reliable the information must:

- Achieve faithful representation – the presentation of transactions and events corresponds with the actual transactions and events
- Be verifiable – an auditor can check its accuracy
- Be free of any bias on the part of the preparer – 'neutrality'; not trying to influence a user

For example, often in accounting there is a need for estimates, such is the case for the valuation of assets.

- How much is the inventory worth? (Inventory can also be called stock or supplies)
- How much is house worth that the business has owned three years?

The preparer of the financial statements should consult with experts and get evidence to support estimates.

COMPARABILITY

This refers to the need for users to compare the information with benchmarks, such as:

- Comparing similar companies in the same industry group
- Comparing one business over different periods of time

If there are any changes in the way the information is prepared, then this should be made known so fair comparisons can be made.

REVISION QUIZ 2

1. Match up the following accounting concepts with their definitions by writing the appropriate letter beside the definition in the table below:

Entity	The financial affairs of the business should be kept separate from the financial affairs of the owner
Going concern	The business will continue to operate into the foreseeable future; there is no intention of the business to stop operating
Monetary	All transactions are measured in a common monetary unit, e.g. New Zealand dollars
Historical cost	All transactions are recorded at their original costs to the entity
Accrual basis	Transactions are recorded in the time period in which they occur, regardless of whether any money has been paid or received
Accounting period	Business activities are divided into regular time periods, such as every 6 months or every year
Qualitative characteristics	Components include relevance, comparability, reliability and understandability

a. Entity
b. Going concern
c. Monetary
d. Historical cost
e. Accrual basis
f. Accounting period
g. Qualitative characteristics

Transactions are recorded in the time period in which they occur, regardless of whether any money has been paid or received	E
The business will continue to operate into the foreseeable future; there is no intention for the business to stop operating	B
Business activities are divided into regular time periods such as every 6 months or every year	F
The financial affairs of the business should be kept separate from the financial affairs of the owner	A
All transactions are recorded at their original costs to the entity	D
Components include relevance, comparability, reliability and Understandability	G
All transactions are measured in a common monetary unit, e.g. New Zealand dollars	C

2. It is important to keep the financial affairs of a business separate to the financial affairs of the owner because:
    a. It enables the correct calculation of taxes
    b. It enables the correct valuation of the business for sales purposes
    c. It enables the correct calculation of profit
    d. Only (a) and (c)
    e. All of the above

3. If a business was to stop trading, i.e. close down, its financial statements would be prepared in a different way than usual.
    a. True
    b. False

4. Businesses should prepare accounting information at regular intervals.
    a. True
    b. False

5. Which of the following accounting periods is not very appropriate for businesses to use:
    a. Annually (every year)
    b. Half yearly (every six months)
    c. Quarterly (every three months)
    d. Daily (every day)

6. An Australian company operating in New Zealand would record its transactions in:
    a. Australian Dollars
    b. New Zealand Dollars
    c. Great Britain Pounds Sterling

7. Lenny bought an office space for $300,000 ten years ago but it is estimated to be worth $500,000 today. According to the historical cost assumption, how much would the office space be recorded as in his financial statements today?
    a. $300,000
    b. $500,000
    c. $200,000

8. Lenny bought office supplies on credit today (he didn't pay for them yet). Should he record this transaction today or wait until he has paid the money?
    a. Record today
    b. Wait until the money is paid

9. Lenny sold some books to a customer on credit (the customer did not pay yet). Is this a sale or not?
    a. This is a sale; Lenny has earned money and the transaction should be recorded
    b. It is not a sale: Lenny should wait until the customer pays before he records the transaction

10. Which of the following is NOT a quality characteristic?
    a. Relevance
    b. Comparability
    c. Reliability
    d. Perishability
    e. Understandability

THE ELEMENTS OF ACCOUNTING

When recording accounting transactions, they must be 'classified' correctly. This means they must be organised or categorised into appropriate groups. Accounting transactions are classified under 'accounting elements.

There are five accounting elements:

ASSETS

An asset is anything owned by a business which has some value; the resources the business uses in its operations. They are the 'service potential' or 'future economic benefits' controlled by a business as a result of past transactions.

Example of assets relating to Bob's Tennis Tours Ltd

- *Past - BTT Ltd received some cash from a customer (who bought a tennis racket)*
- *Future - BTT Ltd will use the money to pay for expenses in running the business*
- *Current - Now BTT Ltd has control over the money in the bank account*

There are **two types** of assets:

Current Assets can be turned into cash easily, or will be used up soon:

- Money in the bank
- Accounts receivable/debtors
- Supplies/inventory/stock
- Prepayments

Non-Current Assets (most are called fixed assets) are kept in the business for a longer time:

- Land/plant/buildings
- Motor vehicles
- Equipment/machinery
- Furniture

(Non-current assets can also include intangible assets such as trademarks and goodwill)

DEPRECIATION

As we have already learned, fixed assets provide the future service potential or economic benefits. However, over time fixed assets sometimes lose their value. For example, they may wear out or become out of date. They lose their ability to be useful and provide income for the business. For this reason, we need to use depreciation.

Depreciation is an expense used to spread the cost of a Fixed Asset over the useful life of the asset; this may take several years. The depreciation of the asset's life every year is added up, this is called accumulated depreciation. When we take away the accumulated depreciation value from the historical cost of the Fixed Asset, we get the current value or **Book Value** (is an estimate of how much it is worth today) of the asset. The current value of the fixed asset will most likely be not equal to the actual market value.

PLEASE NOTE:
You should be able to understand the relationship between non-current assets and accumulated depreciation. See *Adjustments* too.
Make sure you are able to explain why it's necessary to deduct accumulated depreciation from Non-current assets
"Depreciation is the method of accounting used to allocate the cost of a fixed asset over its useful life and is used to account for declines in value. It helps companies avoid major losses in the year it purchases the fixed assets by spreading the cost over several years." Source: Freshbooks

For example: Trading Tours Company bought a Yellow Tour Bus in 2015 for $100,000. The value of the bus has depreciated every year and the accumulated depreciation value to date is $67,232. Therefore, the Book Value of the bus at 31 December 2019 is $32,768.

Tour Bus purchased 01 January 2015 for $100,000 (using IRD Depreciation of 20% pa diminishing value)

01/01/2015 Cost $100,000

31/12/2015 Depreciation @ 20% DV $20,000 B.V. $80,000

OR $100,000 X 80% = $80,000

OR $100,000 X 0.20 = $20,000,

then do $100,000 – $20,000 = $80,000

31/12/2016 Depreciation @ 20% DV $16,000 B.V. $64,000

(Or $80,000 x 80% = $64,000)

31/12/2017 Depreciation @ 20% DV $12,800 B.V. $51,200

31/12/2018 Depreciation @ 20% DV $10,240 B.V. $40,960

31/12/2019 Depreciation @ 20% DV $8,192 B.V. $32,768

B.V = Book Value.
D.V = Diminishing Value

Notice how with the 'diminishing value' means of calculating depreciation, the expense in the first year is higher than the expense in year 5.
The other method is 'Straight Line' which is (for buses) 13% of the original cost every year (i.e. $13,000 pa in our example above.)

Take your phone. How much did you pay for it when you bought it?

____

If you were to **sell** it today how much do you think it would sell for, i.e. how much is it worth today? __________________

As a result, what is the value of depreciation? (Original price – today's value) _____________

Covert this to a yearly percentage _____________________

Some examples are below:

Example 1:

iPhone 7	Bought @	$1200
	Sell today @	$700
	DV Year 1	$500

Total loss as a % (Loss of value / Cost price)

$500 / $1200 = 0.416 rounded up to 0.42 x 100 = **42%**

Example 2:

iPhone SE	Bought @	$1500
	Sell today @	$1200
	DV Year 1	$300

Total loss as a % (Loss of value / Cost price)

$300 / $1500 = 0.2 x 100 = **20%**

If you were to use depreciation of 20% pa diminishing value) over three years:

Year 1	$1200	$1200 x 80% = $960
Year 2	$960	$960 x 80% = $768
Year 3	$768	

Example 3:

iPhone 10	Bought @	$2000
	Sell today @	$1500
	DV Year 1	$500

Total loss as a % (Loss of value / Cost price)

$500 / $2000 = 0.25 x 100 = 25%

If you were to use the depreciation of 25% pa diminishing value) over three years:

Year 1	$1500	$1500 x 75% = $1125
Year 2	$1125	$1125 x 75% = $843.75
Year 3	$843.75	

LIABILITIES

Liabilities are amounts that the business owes to other people or businesses, for things like loans or goods bought on credit. They are future 'sacrifices of service potential' or of 'economic benefits' that the business has to make as a result of past transactions.

Example of liabilities relating to Bob's Tennis Tours Store Ltd

- *Past – BTT Ltd will pay the bill using the money in the bank*
- *Present – Now BTT Ltd has an obligation to the bill; it owes money*
- *Future – BTT Ltd bought new Tennis Rackets last month, on credit*

There are two types of liabilities:

Current Liabilities are due to be paid soon, within a year:

- Accounts payable / creditors
- Accrued expenses
- Bank overdraft
- Revenue received in advance

Non-Current Liabilities will take a longer time to be paid:

- Loan
- Mortgage

PLEASE NOTE:
If a business didn't make enough money to pay staff wages for the month, the organisation may have to take out a loan. A sacrifice of service means that if they didn't, the business would not have anyone to work for them.

Economic benefits: Buy a courier van, put in on credit so it becomes a liability. But the business now delivers twice as many deliveries so more money = more economic benefits

PLEASE NOTE
Definition of ***Revenue Received in Advance***
"Under the accrual basis of accounting, revenues received in advance of being earned are reported as a liability. If they will be earned within one year, they should be listed as a current liability." – Source: Accounting Coach

Read through the following case study about FRESH FRUITS, then answer the questions on the following page.

Assets & Liabilities Group Activity (adapted from bized.co.uk)

Assume that you have decided to set yourself up in a business selling fruit. You have borrowed $100 from your parents, which you have agreed to pay back at the end of the school year. Also, three of you have each put in $20 to the project. You have agreed to split the profits (assuming you make any) equally between yourselves. You have called your business 'Fresh Fruits'.

Your tutor has given you permission to be able to operate and has agreed some premises that you can use to sell your products. There is a small, secure, storeroom, which has been cleaned out and modified, that you are going to use. This acts as your market stall. You have agreed to buy this room and have paid your tutor $30. There is, however, a cleaning cost to be paid on the room, which works out at $5 per week. You have also bought 10 wooden boxes in which to display the fruit, a large secure money box in which to keep your cash and you have bought three new uniforms.

You are in a position to buy your fruit, as you have an uncle who is a greengrocer. He goes to fruit markets every morning to buy his stock and has agreed with you to supply you with fruit from his stock. You provide him with a list of the things you want, and he delivers them to the school first thing in the morning, in return for a small fee to cover his delivery costs.

You arrive at the school and, along with your two friends, unload the fruit and put it onto the display stands ready for business. You sell your fruit for half an hour before school, during break, lunch and then after school for another half an hour.

If there is any leftover fruit, your uncle comes and collects it at the end of the day. However, you still have to pay for that, so it is important that you estimate the likely sales carefully. For the first two weeks, you were not very accurate - on some days you had too much and on others not enough.

Remember!

- *Assets – all the things that the business 'owns'.*
- *Fixed assets – all the things a business owns but which are not used up in production.*
- *Current assets – all the things a business owns which are used up in production.*
- *Having now identified all the things that you have had to buy, there are also things that you will have to pay out to set up and run the business.*
- *Liabilities – refers to the money the business owes to other people.*

1. Make a list of all the things that you have had to buy to get the business up and running.

____

____

____

____

____

____

____

2. Now try to categorise the things in your list into either fixed assets (FA) or current assets (CA).

Fixed assets	room, wooden boxes, money box, uniforms
Current assets:	fruit

3. Make a list of all the liabilities you have in your business.

Owe parents money Owe cleaning expenses Owe Uncle for fruit and delivery

OWNER'S EQUITY

Also known as the **'capital'**, it is 'net worth' of the assets of the business after the liabilities have been subtracted.

CAPITAL = ASSETS - LIABILITIES

Capital can be in the form of cash or assets which the owner has contributed to the business.

The owner can also take items out of the business. We call this a 'withdrawal' or 'drawings'.

Put simply, **owner's equity** is the amount that the owners have invested in their business and includes any profit (or loss) that the company has earnt.

PLEASE NOTE:
The term **"Drawings"** is a term that is used throughout the component, and especially so, when you cover **Financial Statements**

PROFIT = REVENUE - EXPENSES

REVENUE (INCOME)

Revenue is a word used to describe the income coming into the business; gross income earned from doing business. Money can be earned from selling goods (sales) or providing a service (service revenue).

In other words, revenue is inflows of 'service potential' or 'future economic benefits' in the form of increases in assets or reductions in liabilities of the business.

EXPENSES

Expenses are things the business has to pay for. Money will/is going out of the business; and includes the day-to-day costs of running the business.

In other words, expenses are the consumption or 'loss of service potential' or 'future economic benefits' in the form of reductions in assets or increases in liabilities of the business

1. List as many business expenses that you can think of:

   Rent, electricity, insurance, telephone, cleaning, wages, repairs, maintenance, postage, stationery, fuel, parking, travel, miscellaneous

HEADINGS	KEYWORDS
CURRENT ASSETS	ACCOUNTS RECEIVABLE CASH IN BANK INVENTORY
FIXED (NON_CURRENT) ASSETS	FURNITURE, EQUIPMENT VEHICLES, LAND BUILDING
CURRENT LIABILITIES	ACCOUNTS PAYABLE BANK OVERDRAFT
NON-CURRENT LIABILITIES	MORTGAGE TERM LOAN
EXPENSES	ADVERTISING, RENT ELECTRICITY, INSURANCE BANK CHARGES, WAGES
REVENUE	INCOME SERVICE REVENUE SALES REVENUE
OWNER'S EQUITY	CAPITAL, NET LOSS DRAWINGS, NET PROFIT
DEPRECIATION	ACCUMULATED DEPRECIATION VALUE HISTORICAL COST

Classify the following accounts as A - Assets, L - Liabilities, OE Owner's Equity, R - Revenue or E - Expenses.

Account	A, L, OE, R or E
Accounting fees	E
Accounts payable	L
Accounts receivable	A
Bank account	A
Bank fees	E
Capital	OE
Cash at bank	A
Cleaning	E
Computer	A
Drawings	OE
Electricity	E
Equipment	A
Interest paid	E
Insurance	E
Loan	L
Machinery	A
Mortgage	L
Overdraft	L
Plant	A
Petrol	E

Account	A, L, OE, R or E
Printing and stationery	E
Rent	E
Revenue	R
Sales	R
Salaries	E
Service Revenue	R
Telephone	E
Wages	E

Bob owns a Tennis Tours Business called BTT Ltd. Here is a list of items in his business. Write the name of the account involved and classify the account. The first one has been done for you.

A - Assets, **L** - Liabilities, **OE** Owner's Equity, **R** - Revenue or **E** - Expenses.

Item	Account Name	Accounting Element: A, E, L, OE or R
Money in the business bank account	*Bank*	*(A) Asset*
Money invested by Bob into the business	Capital	OE
Tennis Rackets for sale in the Bus	Stock/Inventory	A
Money earned from selling Tennis Rackets	Revenue/sales	R
Shelving and tables in the Bus	Furniture	A
Electricity used in the office	Electricity	E
A loan from the bank	Loan	L
Telephone used in the office	Telephone	E
Depreciation of the shelving	Depreciation	E
Accountancy fees to get tax return done	Accountancy Fees	E
Money in the till	Cash on Hand	A
A cash withdrawal made by Bob	Drawings	OE
Customers who owe money	Accounts receivable	A
Rent for the office	Rent	E
Received an invoice from a supplier	Accounts payable	L

A - Assets, **L** - Liabilities, **OE** Owner's Equity, **R** - Revenue or **E** - Expenses.

Item	Account Name	Accounting Element: A, E, L, OE or R
The business owns a state-of-the-art building in Queenstown	Plant	(A) Asset
The business received an invoice from one of its partners	Accounts Payable	(L) Liabilities
The business earned a net profit for the third quarter totaling NZ$50 million	Net Profit	(OE) Owner's Equity
The business made money by selling its branded merchandise	Revenue/Sales	(R) Revenue
The business had to pay its employees	Wages	(E) Expenses
The business held money in the safe	Cash on Hand	(A) Asset
The business arranged an overdraft with the bank	Overdraft	(L) Liabilities
The owner withdrew cash from the business to pay for a holiday	Drawings	(OE) Owner's Equity
The business made money from selling its services	Service Revenue	(R) Revenue
The business had to pay its accountant	Accounting Fees	(E) Expenses
The business bought a new computer	Computer (or Equipment)	(A) Asset
The business refinanced their mortgage	Mortgage	(L) Liabilities
Over the last financial year, the business made a net loss	Net Loss	(OE) Owner's Equity
The business brought in new business from a joint venture	Sales	(R) Revenue
The business paid for some local advertising	Advertising	(E) Expenses

CHART OF ACCOUNTS

The chart of accounts is basically a list of all the business' financial description accounts. A table of codes (numbers or letters) is used to classify individual transactions into accounts so they can be identified easily. Similar accounts are grouped together using the elements of the accounting equation.

Here is an example:

100	ASSETS	
	101	Bank
	102	Stock (or Supplies)
200	EXPENSES	
	201	Electricity
	202	Rent
300	LIABILITIES	
	301	Loan
400	OWNER'S EQUITY	
	401	Capital
500	REVENUE	
	501	Sales

REVISION QUIZ 3

1. A tour bus is
    a. an asset
    b. an expense
    c. a liability

2. An account payable is
    a. an asset
    b. an expense
    c. a liability

3. Inventories are
    a. an asset
    b. an expense
    c. revenue

4. Interest paid on a bank loan is
    d. owner's equity
    e. an expense
    f. a liability

5. If the owner contributes more money to the business this is
    a. owner's equity
    b. an expense
    c. a liability

6. If the business makes a sale this is
    a. an asset
    b. revenue
    c. a liability

7. An unpaid electricity bill is
    a. an asset
    b. an expense
    c. a liability

8. An electricity bill which has been paid is
    a. an asset
    b. an expense
    c. a liability

9. A deposit received in advance for a tour is
    a. an asset
    b. revenue
    c. a liability

10. Which of the following is not a current asset?
    a. Money in the bank
    b. Tour Bus
    c. Account receivable
    d. Prepayments

11. Which of the following is not a non-current asset?
    a. Building
    b. Equipment
    c. Prepayment
    d. Furniture

12. Which of the following is not a current liability?
    a. Mortgage
    b. Bank overdraft
    c. Accounts payable
    d. Accrued expense

13. Which of the following is not a non-current liability?
    a. Loan
    b. Mortgage
    c. Bank overdraft
    d. They are actually all non-current liabilities

14. Depreciation is a word used to explain that ____________ lose their value over time
    a. Assets
    b. Expenses
    c. Liabilities
    d. Revenue

15. Owner's equity can include:
    a. Capital
    b. Drawings
    c. Retained earnings
    d. All of the above

THE ACCOUNTING EQUATION

Assets + Expenses = Liabilities + Owner's Equity + Revenue

The important point to note in relation to the accounting equation is that it must always balance. This means that both sides should be the same (equal).

The Double Entry System

- The double entry system is used to record accounting transactions in a way that keeps the equality of the accounting equation.
- **A transaction is an exchange; there will be something of value coming into the business while something is going out.**
- **Each business transaction is entered twice, once as a debit, and then as a credit.**

Assets + Expenses		=	Liabilities + Owner's Equity + Revenue
Debit (DR) Balance Debit to increase Credit to decrease			Credit (CR) CR balance Credit to increase Debit to decrease

The double entry system is used because it acknowledges that the 'benefit' value of assets and resources is exactly matched by an equivalent 'obligation' value in liabilities to creditors and owner's equity.

1. State the benefit and obligation for each of the following transactions. Also try to indicate next to the benefit or obligation, which 'element' in the accounting equation it corresponds to, for example asset, expense, liability, owner's equity, or revenue.

What elements of the accounting equation have been affected?

We have completed the first one for you.

TRANSACTION	TRANSACTION ONE	TRANSACTION TWO
Buy a new computer, paying in cash	Computer (Increase asset, Dr) which can be used to operate the business	Have to pay for it, so less cash than before (Decrease Asset, Cr)
Buy a new computer on credit	Computer (Increase asset, Dr) which can be used to operate the business	Have to pay for it in the future (Increase liability, Cr); owe someone money
Pay off the account when you receive the invoice	Don't owe money anymore (Decrease liability, Dr)	Less money in bank (Decrease asset, Cr)
Sell the computer	Money in the bank (increase asset, Dr)	No computer anymore (decrease asset, Cr)
Sell goods to a customer for cash	Money in the bank (increase asset, Dr)	Have to give the goods to the customer once sold (Increase Revenue - Cr)
Sell goods to a customer on credit	Account receivable (asset); someone owes you money in the future (Dr)	You have to give them the goods, less stock (asset) than before (Cr)

2. Moe sells beer in his pub. For each of the following situations, state whether it is an accounting transaction, and if so, which of the accounting 'elements' are involved.
    a. A complaint from a customer about bad tasting beer
    No

    b. Selling two bottles of beer to a customer who pays in cash
    Yes (asset-bank, revenue-sales)

    c. Selling two bottles of beer to a customer who will pay later
    Yes (asset-accounts receivable, revenue-sales)

    d. Payment received from the customer in payment of his account
    Yes (asset-bank, asset-acc rec)

    e. A quote given to a customer for hiring the bar for a private party
    No

    f. Purchase of stocks of beer, on credit

Yes (asset-inventory, liability-acc pay)

g. An employee timesheet
   No

h. Paying the employee his wages
   Yes (asset-bank, expense-wages)

3. Moe's bar owns an old computer, which originally cost $950, but is now useless. Explain why this computer is, or is not, an asset.
   Not an asset. An asset is anything owned by a business, which has some value; the resources the business uses in its operations. The computer is useless so therefore has no value.

4. Moe receives $800 from Homer for lay-by sales of beer that are still to be completed at balance date. Explain why the $800 is, or is not, revenue in the current accounting period.
   No. Moe has not actually earned any money yet. It is revenue received in advance. It is an obligation to give Homer beer (inventory) in the future.

THE ACCOUNTING EQUATION: *Example – ABC Ltd, a company owned by Joe*

	Assets	+	Expenses	=	Liabilities	+	Owner's Equity	+	Revenue
	DR	+	DR	=	CR	+	CR	+	CR
Explanation	Things that ABC own that belong to the business		Expenditure that ABC has paid for, money going out, bills or invoices paid		Things that ABC has not paid for yet, money owed, bills which have to be paid in the future		Things that Joe has personally put into the business and his current ownership in the business		The money that ABC earns, money coming in (income)
Examples	Cash/bank Buildings/factory/plant Stock/supplies/inventory Motor vehicles/car/truck Equipment/machinery Furniture/fixtures (Accumulated depreciation means assets are losing their value) Debtors/accounts receivable/ accrued service revenue→ABC is waiting to receive money from someone, it made a sale and earned the revenue but just hasn't been paid yet Allowance for doubtful debts Prepayments→ABC paid for something in advance It has not received or used it yet, whoever ABC paid the money to now owes ABC something in the future		Expenses incurred in the everyday running of the business→ Rent/rates Salaries/wages Advertising Power/electricity Insurance Bank charges Accounting fees Depreciation expense Bad debts Doubtful debts expense		Loan Overdraft Mortgage Hire purchase Credit card Creditors/accounts payable/ accrued expenses→ ABC owes money to another businesses, it got something but hasn't paid for it yet Unearned revenue→ that ABC received, money came in, but ABC didn't do anything to earn it, ABC owes somebody something in the future		Capital (+)→money and/or assets Joe puts into the business Drawings (-)→money and/or assets Joe takes out of the business Net profit (Revenue-expenses) Retained earnings→ profit earned by Joe that he re-invests back into the business		Money ABC receives from making a sale→ Sales revenue/ service revenue/ revenue earned/ revenue received Other ways of money coming in→ Interest received Dividend revenue Sale of assets
Recording in journals and ledgers	Increase (+) → Debit Decrease (-) → Credit (Accumulated depreciation is a credit because it is decreasing the value of the asset)		Increase (+) → Debit Decrease (-) → Credit		Increase (+) → Credit Decrease (-) → Debit		Increase (+) → Credit Decrease (-) → Debit		Increase (+) → Credit Decrease (-) → Debit
Statement	Financial position		Financial performance		Financial position		Movements in equity		Financial performance

PLEASE NOTE: Under **Current Assets**, there is a requirement to deduct the allowance for **doubtful debts** from accounts receivable. Under **Non-Current Assets**, there is a requirement to deduct **accumulated depreciation**

Example of the Accounting Equation & Double Entry:

Here is a list of some transactions that Bob carried out in October 2009:

1. Paid for $1,000 of advertising
2. Made cash sales of $2,500
3. Contributed $2,000 of personal cash (capital) into the business bank account
4. Bought a mobile phone for $500, paying by EFTPOS, from the business account
5. Borrowed a loan of $5,000 from the bank

Here is the effect of each transaction on Bob's accounting equation:

	Assets		+	Expenses		=	Liabilities		+	Owners Equity		+	Revenue	
1	Bank	- 1,000		Advertising	1,000									
2	Bank	+ 2,500											Sales	+ 2,500
3	Bank	+ 2,000								Capital	+ 2,000			
4	Equipment	+ 500												
	Bank	- 500												
5	Bank	+ 5,000					Loan	5,000						
		8,500	+		1,000	=		5,000			2,000			2,500
					9,500	=	9,500							

The example explained

1. The advertising decreases (credits) the bank account and increases (debits) the expenses account.
2. The cash sales increases (debits) the bank account and increases (credits) the revenue account.
3. The money contributed increases (debits) the bank account and increases (credits) the owner's equity account.
4. The purchase of the mobile phone increases (debits) one asset (the mobile phone) and decreases (credits) another asset (the bank account).
5. The loan increases (debits) the bank account and increases (credits) the loan account.

Remember:

1. For each transaction there must be two entries: one debit, one credit
2. The debit value must be equal to the credit value
3. The accounting equation must balance

State the element that has affected each of the transactions below.

For example, for line item (1), explain the transaction that occurred to make the account +$15,000?

	Assets			=	Liabilities	+	Owner's Equity
	Bank	Car	Equipment	=	Loan	+	Capital
1	+15,000			=		+	+15,000
2	+12,000			=	+12,000	+	
3	-10,000		+10,000	=		+	
4		+42,000		=		+	+42,000
5	-1,000			=	-1,000	+	
			68,000	=	68,000		

Transactions explained.

1. Owner contributed personal money to the business bank account
2. Got a loan, money in the bank
3. Bought new equipment
4. Owner contributed a car to the business
5. Paid money off the loan

1. Write a brief statement for each of the transactions below to explain what has happened.

	Assets	+	Expenses		Liabilities		+	OE	+	Revenue
	Bank	+	Phone	=	Loan	Acc Pay	+	Capital	+	Sales
1	-120		+120	=			+			
2	+2,000			=	+2,000		+			
3	-300			=		-300	+			
4	+800			=			+	+800		
5	+500			=			+			+500
			3,000	=	3,000					

Transactions explained.

1. Paid phone bill
2. Got a loan
3. Paid a bill
4. Owner contributed cash
5. Made sales

PLEASE NOTE:
Re: The accounting equation: This always must resemble a “debit” & “credit” transaction. Each side must equal each other. One side has to be a “+” and the other side a “-“ = 0 to balance

1. **Record the following transactions in the accounting equation**.

1	Received $900 from customers who paid their accounts
2	Received payment for sales made, $800
3	Paid accounts payable of $500
4	Paid $450 for van repairs

Key: Acc Rec = Accounts Received

5	Sent invoices to customers for sales made, $1,200
6	Paid wages, $800
7	Paid loan, $300
8	Bought a new van on credit for $6,000
9	Owner withdrew $900 for personal use

The answers are on the next page.

	Assets				Expenses			Liabilities			Owner's Equity			Revenue
	Bank	Acc Rec	Van	+	Repairs	Wages	=	Loan	Acc Pay	+	Capital	Drawings	+	Revenue
1	+900	-900												
2	+800													+800
3	-500								-500					
4	-450				+450									
5		+1200												+1200
6	-800					+800								
7	-300							-300						
8			+6000						+6000					
9	-900											-900		
	-1250	+300	+6000		+450	+800		-300	+5500			-900		+2000
	6300						=	6300						

2. **Record the following transactions in the accounting equation.**

1	Paid $1,500 for rent
2	Made credit sales of $2,000
3	Paid wages of $1,800
4	A car valued at $2,400 was contributed by the owner

Key: Acc Rec = Accounts Received

5	Paid loan repayment of $500
6	Received electricity bill, but have not paid the $240
7	Owner withdrew $200 from the business bank account
8	Made cash sales of $500
9	Received $2,000 from customers paying their accounts

The answers are on the next page.

	Assets				Expenses				Liabilities			Owner's Equity			Revenue
	Bank	Acc Rec	Car	+	Rent	Wages	Electricity	=	Loan	Acc Pay	+	Capital	Drawings	+	Sales
1	-1500				+1500										
2		+2000													+2000
3	-1800					+1800									
4			+2400									+2400			
5	-500								-500						
6							+240			+240					
7	-200												-200		
8	+500														+500
9	+2000	-2000													
	-1500	0	+2400		+1500	+1800	+240		-500	240		+2400	-200		+2500
	4440							=	4440						

3. **Record the following transactions in the accounting equation. Try to do it without using account names.**

July 1	Received $200 cash from client for goods sold
July 2	Bank fees of $15 were deducted from bank account
July 3	Paid insurance $150
July 4	Received $120 cash from client for goods sold
July 5	Paid $34 for stationery

July 6	Took weekly drawings of $450
July 7	Received $150 cash from client for goods sold
July 8	Paid rent $400
July 9	Bought new exercise bike, on credit from FitEquip Ltd, $800
July 10	Invested $2,000 of personal cash into the business

The answers are on the next page.

	Assets	+	Expenses	=	Liabilities	+	Owner's Equity	+	Revenue
1	+200								+200
2	-15		+15						
3	-150		+150						
4	+120								+120
5	-34		+34						
6	-450						-450		
7	+150								+150
8	-400		+400						
9	+800				+800				
10	+2000						+2000		
	+2221		+599		+800		+1550		+470
	+2820			=	+2820				

4. Kylie set up in business as a Bed & Breakfast. Record her transactions in the accounting equation.

Try to do it without using individual account names.

1	She contributed $20,000 cash.
2	Furniture and fittings are worth $20,000 to the business.
3	The business paid rent of $1,100.
4	Kylie had someone stay and sent the client an invoice for $500.
5	The business bought $1,200 worth of furniture on credit.
6	The business paid cleaning wages of $290.
7	The client paid the $500 he owed.
8	Kylie had someone stay for 2-weeks and sent out invoices totalling $2,300.
9	Kylie drew $500 out of the business bank account for her private living expenses.
10	The business sold $100 worth of furniture for cash.
11	The business paid $290 in cleaning wages.

The answers are on the next page.

	Assets	+	Expenses	=	Liabilities	+	Owner's Equity	+	Revenue
1	+20000						+20000		
2	+20000						+20000		
3	-1100		+1100						
4	+500								+500
5	+1200				+1200				
6	-290		+290						
7	+500 -500								
8	+2300								+2300
9	-500						-500		
10	-100 +100								
11	-290		+290						
	+41820		+1680		+1200		39500		2800
	+43500			=	43500				

5. State the effect each transaction would have on the accounting equation.

		Effect on Expanded Accounting Equation	
		Debit	Credit
Transactions		Type and Name of Account	Type and Name of Account
1	Sold goods on credit to GP Ltd for $100	Assets - Account Receivable	Revenue - Sales
2	Purchased goods worth $1,000 paying in cash	Assets - inventory / stock / supplies	Asset - bank
3	Purchased goods from supplier on credit for $720	Assets - inventory / stock / supplies	Liability - accounts payable
4	Took drawings of $80	Owner's Equity - drawings	Asset -bank
5	Paid wages of $650	Expenses - wages	Asset -bank
6	Sold goods worth $45 to a customer, Mr Blue who paid in cash	Asset - bank	Revenue - sales
7	Sold goods worth $40 on credit to a customer who didn't pay yet	Asset - account receivable	Revenue - sales
8	Purchased furniture on credit for $2,700	Asset - furniture	Liability - account payable
9	Made cash sales of $180	Asset - bank	Revenue - sales
10	GP Ltd paid their account in full	Asset - bank	Asset - account receivable
11	Received a loan of $5000 from the bank	Asset -bank	Liability - loan

Debit and Credit – Double Entry System.

Analyse the following two transactions and fill in the tables:

Transaction 1	Accounts Affected	Element (A, E, L, OE, R)	Debit or Credit
Earned revenue $200	*Bank*	*A*	*Debit*
	Revenue	R	Credit
Paid rent $600	Rent	E	Debit
	Bank	A	Credit
Owner withdrew $500	Drawings	OE	Debit
	Bank	A	Credit
Bought goods on credit $400	Inventory	A	Debit
	Accounts Payable	L	Credit
Bought computer for office $2,000	Computer	A	Debit
	Bank	A	Credit
Bought stationery, paid in cash $40	Stationery	E	Debit
	Bank	A	Credit
Paid for advertising $650	Advertising	E	Debit
	Bank	A	Credit
Paid loan repayment $300	Loan	L	Debit
	Bank	A	Credit
Owner contributed furniture to business	Furniture	A	Debit
	Capital	OE	Credit

Transaction 2	Accounts Affected	Element (A, E, L, OE, R)	Debit or Credit
Pauline started a SPA and Beauty business and introduced some cash	Bank	A	Debit
	Capital	OE	Credit
The business bought some salon furniture on credit	Furniture	A	Debit
	Accounts payable	L	Credit
The SPA & Beauty business charged a client for last night (unpaid)	Accounts receivable	A	Debit
	Revenue	R	Credit
A supplier paid money into the SPA and Beauty business account	Bank	A	Debit
	Accounts receivable	A	Credit
The SPA & Beauty business bought branded stationery/merchandise on credit	Stationery	E	Debit
	Accounts payable	L	Credit
The SPA & Beauty business bought a vehicle on credit	Vehicle	A	Debit
	Accounts payable	L	Credit
The SPA & Beauty business received cash for a customer who visited last night	Bank	A	Debit
	Revenue	R	Credit
Pauline took some branded SPA & Beauty products home	Drawings	OE	Debit
	Spa & Beauty products	E	Credit
Pauline took out a loan from the bank to buy a computer for the business	Bank	A	Debit
	Loan	L	Credit
The business paid for electricity	Electricity	E	Debit
	Bank	A	Credit

REVISION QUIZ 4

Multi Choice

1. Vehicle is an asset. If another vehicle was purchased the debit balance would be:
    a. Decreased
    b. Unchanged
    c. Increased

2. To decrease a debit balance you have to__________it
    a. Credit
    b. Debit

4. Accounts payable are liabilities and should have a
    a. Credit
    b. Debit

5. If assets are $5,000 and owner's equity is $2,000 then liabilities are
    a. $7,000
    b. $3,000
    c. $4,000

6. When more inventories are purchased on credit the accounts payable are
    a. Decreased
    b. Unchanged
    c. Increased

7. Interest paid on a bank loan is
    a. An asset
    b. An expense
    c. A liability

8. If the owner contributes more money to the business the owner's equity is
    a. Increased
    b. Unchanged
    c. Decreased

9. For question 7 above the bank account balance is
    a. Debited
    b. Unchanged
    c. Credited

10. If a vehicle asset worth $5,000 is sold for $5,000 cash what is the effect on the accounting equation? Are assets
    d. Increased
    e. Unchanged
    f. Decreased

11. In the general ledger bank overdraft would have a _________ balance
    a. Debit
    b. Credit
    c. Cash

1. Joe owns a small Motion Master Pop-up called Motion Master Today. A summary of one week's transactions is given in the table below.
    a. Analyse the transactions and fill in the table (see next page)
       (Unless stated otherwise, all transactions are cash; GST is ignored)

	Transaction	Effect on Accounting Equation	Account Name	Debit or Credit
	Example: Paid electricity bill	*Increase expense*	*Electricity*	*Debit*
		Decrease asset	*Bank*	*Credit*
1	Joe withdrew $200	Decrease Owner's equity	Drawings	Debit
		Decrease Asset	Bank	Credit
2	Earned revenue $2,400	Increase Asset	Bank	Debit
		Increase Revenue	Sales	Credit
3	Paid rent $600	Increase Expense	Rent	Debit
		Decrease Asset	Bank	Credit
4	Paid loan repayment $300	Decrease Liability	Loan	Debit
		Decrease Asset	Bank	Credit
5	Bought stationery $40	Increase Expenses	Stationery	Debit
		Decrease Asset	Bank	Credit
6	Paid for advertising $550	Increase Expense	Advertising	Debit
		Decrease Asset	Bank	Credit
7	Bought computer on credit $4,000	Increase Asset	Computer	Debit
		Increase Liability	Acc. Payable	Credit
8	Joe contributed furniture worth $120 to the business	Increase Asset	Furniture	Debit
		Increase Owner's equity	Capital	Credit
9	Bought inventory on credit $600	Increase Asset	Inventory	Debit
		Increase Liability	Acc. Payable	Credit
10	Sold Motion Masters on credit to I-Site Ltd $45	Increase Revenue	Sales	Credit
		Increase Asset	Acc. Receivable	Debit

B. Record these transactions in the following expanded accounting equation.

	Assets	+	Expenses	=	Liabilities	+	Owner's Equity	+	Revenue
1	-200						-200		
2	+2,400								+2,400
3	-600		+600						
4	-300				-300				
5	-40		+40						
6	-550		+550						
7	+4,000				+4000				
8	+120						+120		
9	+600				+600				
10	+45								+45
	+5,475	+	+1,190	=	+4,300	+	-80	+	+2,445
	6,665			=	6,665				

C. Based on the previous transactions, prepare a chart of accounts for Motion Master Today.

100		Assets	200		Expenses	300		Liabilities
	101	Bank		201	Rent		301	Loan
	102	Computer (E.g. as Stock, or Supplies)		202	Stationery		302	A/C payable
	103	Furniture		203	Advertising	400		Owner's Equity
	104	Inventory					401	Drawings
	105	Accounts Receivable					402	Capital
						500		Revenue
							501	Sales

THE ACCOUNTING SYSTEM

Accounting is a system. It has inputs, processes, and outputs.

Accounting is a process; evidence of business transactions is collected, transactions are recorded, information is summarised, then reported, then analysed and stored; this allows business decisions to be made.

The Accounting System is sometimes referred to as the 'accounting cycle' because it continues from one year to the next.

SOURCE DOCUMENTS

The word source means origin; it is where something comes from. 'Source documents' are things like invoices (bills), receipts, cheque butts, bank statements etc.

What is a business transaction? (Answers may vary)

A business transaction is an event involving an interchange of goods, money or services between two or more parties. The transaction can be as brief as a cash purchase or as long-lasting as a service contract extending over years. The business transacted can be between two parties engaged in business and conducting the transaction for their mutual benefits, or between a business entity, like a retail shop, and a customer. **Source:** [Chron]

What is an account? (Answers may vary)In accounting, an account is a record in the general ledger that is used to sort and store transactions. For example, companies will have a Cash account in which to record every transaction that increases or decreases the company's cash. Another account, Sales, will collect all of the amounts from the sale of merchandise. Most accounting systems require that every transaction will affect two or more accounts. For example, a cash sale will increase the Cash account and will increase the Sales account.

Source: [Accounting Coach]

A source document is the first step in recording the evidence of a transaction. It provides details of the business transactions which need to be put into the business accounts. They are the evidence that the transaction has taken place – used for internal control and audit purposes. No transaction should take place unless it is supported by a source document.

JOURNALS

Journals are used to record the day-to-day accounting transactions. They are sometimes called ‘books of first entry’ because this is where the first accounting record of a transaction is made. All the accounting transactions are entered one after another in date order, therefore, the journal contains a complete history of the transactions as they occur.

MAIN TYPES OF JOURNALS

Journal	Used to record:
1. Cash Receipts	Money coming in Cash sales and revenue received from customers
2. Cash Payments	Money going out Paying for expenses and buying inventory
3. Sales	Credit sales Selling things to customers who have not yet paid
4. Purchases	Credit purchases Buying things but not paying for them yet
5. General	Unusual or uncommon transactions E.g. transactions affecting owner’s equity, buying assets or balance day adjustments

CASH RECEIPTS JOURNAL

The cash receipts journal is used to record all the cash receipts, both electronic and manual; all the money going into the business bank account.

- Bank is an asset. To increase the value of an asset, we 'debit' it.
- Accounts receivable is also an asset, but this time the customers are actually paying the money they owe so the value of the account receivable is going to be less. To decrease an asset; we 'credit' it.
- Sales and interest received are both forms of revenue. To increase the value of revenue; we 'credit' it.

Example: Shelly's Shop had the following cash receipts for April 2009:

April	1	Received payment from Mr Brown, $4,500
	5	Received payment from Ms Grey, $7,250
	10	Cash sales, $21,000
	15	Received interest from bank, $160
	22	Received payment from Mr Green, $12,100
	25	Received payment from Ms Black, $2,000
	28	Cash sales, $19,030

The cash receipts journal is as follows:

Money is **going into** the bank account, so it is debited.

To increase the value of Revenue accounts, we credit them.

Date	Particulars	Bank	Sales	Acc Rec	Interest
Apr-01	Mr Brown	4,500.00		4,500.00	
Apr-05	Ms Grey	7,250.00		7,250.00	
Apr-10	Cash sales	21,000.00	21,000.00		
Apr-15	Interest	160.00			160.00
Apr-22	Mr Green	12,100.00		12,100.00	
Apr-25	Ms Black	2,000.00		2,000.00	
Apr-28	Sales	19,030.00	19,030.00		
		66,040.00 Dr	40,030.00 Cr	25,850.00 Cr	160.00 Cr

The total of all credits should be equal to the debits.

As you can see, each transaction is recorded in two places: once as a debit and once as a credit. This is the double entry system, and it is used to keep the equality of the accounting equation.

Assets	+	Expenses	= Liabilities	+ Owner's Equity	+ Revenue
66,040.00	+	0	= 0	+ 0	+ 40,030.00
					+ 25,850.00
					+ 160.00

Record the following transactions in the cash receipts journal:

July 11	Received $2,987 from Mr Flanders who paid their account in total.
July 11	Cash sales of $3,908 were made
July 12	Received $6,485 from Mr Skinner in full settlement of his account
July 12	Cash sales of $2,906 were made
July 13	Cash sales of $3,907 were made

Date	Details	Bank	Acc. Rec.	Sales
11/07	Mr. Flanders	2,987	2,987	
11/07	Sales	3,908		3,908
12/07	Mr. Skinner	6,485	6,485	
12/07	Sales	2,906		2,906
13/07	Sales	3,907		3,907
		20,193	9,472	10,721

CASH PAYMENTS JOURNAL

The cash payments journal is used to record all payments, both electronic and manual; all the money going out of the business bank account.

- Bank is an asset. To decrease the value of an asset; we 'credit' it.
- Accounts payable is a liability. To decrease a liability, we 'debit' it.
- Payments for things like stationery and rent are expenses. To increase the value of an expense; we 'debit' it.

Example: Shelly's Shop had the following cash payments for April 2009:

April	1	Bought stationery from Paper Plus, $69.56
	5	Paid wages, $1,236
	10	Paid outstanding electricity bill, $94.30
	15	Paid outstanding telephone bill, $173.50
	22	Paid rent, $1,125
	28	Paid wages, $1,158

The cash payment journal is as follows:

Money **taken out of** the bank, increases the account so it is credited.

To decrease the value of Revenue accounts, we debit them.

Date	Particulars	Bank	Acc Pay	Stationery	Wages	Rent
Apr-01	Paper Plus	69.56		69.56		
Apr-05	Wages	1,236.00			1,236.00	
Apr-10	Meridian	94.30	94.30			
Apr-15	Telecom	173.50	173.50			
Apr-22	Rent	1,125.00				1,125.00
Apr-28	Wages	1,158.00			1,158.00	
		3,856.36 Cr	267.80 Dr	69.56 Dr	2,394 Dr	1,125.00 Dr

The total of all debits should be equal to the credits.

Once again, each transaction is recorded in two places: once as a debit and once as a credit. This is the double entry system, and it is used to keep the equality of the accounting equation.

Assets	+	Expenses	= Liabilities	+ Owner's Equity	+ Revenue
-3,856.36	+	69.56	= -267.80	+ 0	+ 0
	+	2,394.00	=		
	+	1,125.00	=		

Record the following transactions in the cash payments journal:

July 1 Purchased goods for resale, $350

July 1 Paid rent, $900

July 3 Paid for cleaning, $96

July 4 Wages of $765 were paid

July 4 Purchased stationery, $35

July 5 Paid creditor, S Brown for legal services $250

July 5 Paid creditor, Radio NZ, $1,500 for advertising

Date	Detail	Bank	Purchases	Rent	Cleaning	Wages	Stationery	Acc Pay
01/07	Purchases	350	350					
01/07	Rent	900		900				
03/07	Cleaning	96			96			
04/07	Wages	765				765		
04/07	Stationery	35					35	
05/07	S Brown	250						250
05/07	Radio NZ	1,500						1,500
		3,896 cr	350 dr	900 dr	96 dr	765 dr	35 dr	1750 dr

SALES JOURNAL

The sales journal is used to record credit sales such as when a customer buys something but does not pay money yet, i.e. accounts receivable.

- Accounts receivable is an asset. To increase the value of an asset we 'debit' it.
- Sales is revenue; the company has earned money. To increase revenue, we 'credit' it.

Example: Shelly's Shop had the following credit sales for April 2009:

April	2	Sold goods on credit to Mr Smith, $3,500
	6	Sold goods on credit to Mr Jones, $4,600
	09	Sold goods on credit to Ms Martin, $9,105
	16	Sold goods on credit to Mr Brooke, $5,250
	22	Sold goods on credit to Mr Wood, $6,930

The sales journal is as follows:

Being that money will be coming, we need to increase the Accounts Receivable account by debiting it.

To increase the value of Sales account, we credit it.

Date	Particulars	Acc Rec	Sales
Apr-02	Mr Smith	3,500.00	3,500.00
Apr-06	Mr Jones	4,600.00	4,600.00
Apr-09	Ms Martin	9,105.00	9,105.00
Apr-16	Mr Brooke	5,250.00	5,250.00
Apr-22	Mr Wood	6,930.00	6,930.00
		29,385.00 Dr	29,385.00 Cr

Assets	+	Expenses	= Liabilities	+ Owner's Equity	+ Revenue
29,385.00			=		29,385.00

Record the following transactions in the sales journal:

Jul 01 Sold goods on credit to Mr Flanders, $2,987

Jul 02 Sold goods on credit to Mr Skinner, $6,485

Jul 04 Sold goods on credit to Mr Wigham, $2,809

Jul 08 Sold goods on credit to Mr Flanders, $2,987

Date	Details	Acc. Rec.	Sales
01/07	Mr. Flanders	2,987	2,987
02/07	Mr Skinner	6,485	6,485
04/07	Mr Wigham	2,809	2,809
08/07	Mr. Flanders	2,987	2,987
		15,268 dr	15,268 cr

PURCHASES JOURNAL

The purchases journal is used to record credit purchases such as when the company buys good s or services but does not pay money yet, i.e. accounts payable.

- Accounts payable is a liability. To increase the value of a liability we 'credit' it.
- Purchases means stock/inventory/supplies are bought for resale; this is an asset.
- To increase an asset, we 'debit' it. Items like electricity and telephone are expenses. To increase an expense, we 'debit' it.

Example: Shelly's Shop had the following credit purchases for April 2009:

April 14 Received invoice from Meridian Energy (electricity bill), $98.65

18 Received invoice from Telecom (telephone bill), $194.50

22 Bought goods on credit from AB Wholesaler Ltd, $3,654.00

26 Bought goods on credit from Fresh Supplies Ltd, $6,033.00

The purchases journal is as follows:

Being that money will be going out, the liability increases. To increase Accounts Payable, we credit it.

To increase the value of the asset; Purchases and increase the Expenses, we debit them.

Date	Particulars	Acc. Pay	Purchases	Electricity	Telephone
Apr-14	Meridian	98.65		98.65	
Apr-18	Telecom	194.50			194.50
Apr-22	AB Wholesaler Ltd	3,654.00	3,654.00		
Apr-26	Fresh Supplies Ltd	6,033.00	6,033.00		
		9,980.15 Cr	9,687.00 Dr	98.65 Dr	194.50 Dr

Assets	+	Expenses	= Liabilities	+ Owner's Equity	+ Revenue
9,687.00		98.65	= 9,980.15		
		194.50	=		

Record the following transactions in the purchases journal:

July 3 Purchased goods for resale from Trents Wholesale, $3,907

July 7 Purchased goods for resale from Cadburys, $4,065

July 15 Received electricity bill from Genesis, $114

July 23 Purchased goods for resale from Trents Wholesale, $2,965

July 27 Received invoice from AMI Insurance, $1,975

July 30 Received invoice from Telecom, $274

Date	Detail	Acc. Pay	Purchases	Electricity	Insurance	Phone
03/07	Trents Wholesale	3,907	3,907			
07/07	Cadburys	4,065	4,065			
15/07	Genesis	114		114		
23/07	Trents Wholesale	2,965	2,965			
27/07	AMI Insurance	1,975			1,975	
30/07	Telecom	274				274
		13,300 cr	10,937 dr	114 dr	1,975 dr	274 dr

GENERAL JOURNAL

The general journal is used to record all other financial transactions that do not fit into the cash receipts, cash payments, sales or purchases journals. They are uncommon or unusual transactions, so we need to give more information for each transaction, therefore, the format of the general journal is quite different to the other journals.

The general journal is mainly used to record the following types of transactions:

- Contributions and withdrawals (when the owner puts something in or takes something out of the business).
- Bad debts written off (when you realise that accounts receivable will never be able to pay you the money they owe you, write this off as an expense; we will study this later).
- Balance day adjustments (we will study this later).
- Sometimes the purchase and sale of assets is recorded here but other journals could also be used, it depends on the individual business' preference.

PLEASE NOTE: Eventually, if the money remains unpaid, it will become classified as **"bad debt".** This means the company has reached a point where it considers the money to be permanently unrecoverable and must now account for the loss. Bad debt will be reflected on a company's income statement (or (P&L)
Source: Freshbooks

Example: Shelly's Shop had the following unusual transactions

April 1	Shelly contributed a motor vehicle valued at $15,000 to the business.
15	Shelly withdrew $500 from the business.

The opening general journal entries:

Indent the second (credit) entry

Date	Details	Debit	Credit
Apr-14	Motor Vehicle	15,000	
	Capital		15,000
	To record owner contributing a motor vehicle		
Apr-18	Drawings	500	
	Bank		500
	To record owner withdrawing cash		

Debit entries are always recorded first

Narrations are necessary to explain the transaction

As with the other journals, the debits must be equal to the credits.

Assets	+	Expenses	= Liabilities	+ Owner's Equity	+ Revenue
15,000			=	+ 15,000	
- 500			=	- 500	
		14,500	= 14,500		

Record the following transactions into the general journal:

01 July Apu contributed a delivery van worth $10,000 to the business

02 July Apu took drawings of $500 from the business

Date	Details	Debit	Credit
01/07	Van	10,000	
	Capital		10,000
	To record owner contributing van to the business		
02/07	Drawings	500	
	Bank		500
	To record owner withdrawing cash from the business		

Which journal (GJ, SJ, PJ, CRJ or CPJ) did you use to record the following transactions?

Transaction	Journal
Sold goods on credit to Mr Skinner, $6,485	Sales
Cash sales of $3,908 were made	Cash Receipt
Received invoice from AMI Insurance, $1,975	Purchase
Apu contributed a delivery van worth $10,000 to the Business	General
Purchased goods for resale from Trents Wholesale, $2,965	Purchase
Paid rent, $900	Cash Payment
Received $6,485 from Mr Skinner in full settlement of his account	Cash Receipt
Purchased stationery, $35	Cash Payment

Which journal would you record the following transactions? (GJ, SJ, PJ, CRJ or CPJ)

Paid rent	CPJ
Customer paid off their account	CRJ
Bought furniture on credit	PJ
Received interest from bank	CRJ
Paid loan	CPJ
Adjusted for prepaid rent	GJ
Owner contributed cash to business	CRJ OR GJ
Received cash for sales	CRJ
Earned service revenue; received payment	CRJ
Paid electricity bill	CPJ
Paid for furniture we previously purchased on credit	CPJ
Bought office supplies on credit	PJ
Bought office supplies paying in cash	CPJ
Owner withdrew money from business	CPJ OR GJ
Purchased new equipment on credit	PJ
Debtor paid what he owed	CRJ
Earned service revenue; didn't receive payment yet	SJ

Multiple Choice – into which journal would you enter each transaction?

1. Sales of the asset vehicle for cash:
    a. Sales
    b. General
    c. Cash receipts

2. Purchase of a vehicle on credit
    a. Purchases
    b. General
    c. Cash payments

3. Inventories purchased but not yet paid for
    a. General
    b. Cash payments
    c. Purchases

4. The owner withdraws inventories for his own use
    a. General
    b. Sales
    c. Cash payments

5. An adjustment of an account at balance day
    a. General
    b. Purchased
    c. Cash receipts

6. The amount of daily cash sales
    a. Sales
    b. Cash receipts
    c. Cash returns

7. Inventories sold on credit to a customer
    a. Sales
    b. Cash receipts
    c. General

8. An opening entry to start the business
    a. Once only journal
    b. Cash receipts
    c. General

9. Paying the electricity bill
    a. Sales
    b. Cash receipts
    c. Cash payments

10. The owner contributes cash to the business
    a. Cash receipts
    b. General
    c. Sales

Here is the chart of accounts for Plenty of Plants Ltd, a plant shop:

100 Assets		300 Liabilities	
101	Bank	301	Accounts ~~Receivable~~ payable
102	Accounts ~~Payable~~ receivable	302	Bank Loan
103	Delivery Van	303	Mortgage
104	~~Capital~~ Computer		
105	Purchases		
106	Furniture		
107	Equipment	400 Owner's equity	
		401	~~Computer~~ Capital
		402	Drawings
200 Expenses		500 Revenue	
201	Insurance	501	Sales
202	Wages	502	Interest Received
203	Petrol		
204	Window cleaning		
205	Electricity		

1. Four accounts are in the wrong place. Make the necessary changes by drawing a line through the accounts that are in the wrong place and write the correct account beside it.

2. Add the following accounts into the appropriate category and number them accordingly.

Drawings 402	Bank Loan 302
Insurance 201	Furniture 106
Wages 202	Interest Received 502
Purchases 105	Equipment 107
Petrol 203	Mortgage 303
Window Cleaning 204	Electricity 205

GST

1. What do you know about GST?

   GST is tax on goods and services. The GST rate is 15%.
   Source: NZ Government

2. How is it different to other types of tax?

   Income tax is a tax on profit, while GST is a tax on consumption.
   Source: AgBiz Accountants

Statutory Requirements

Under the Goods and Services Tax Act 1985, all businesses must register for GST if their turnover

- for the last 12 months was $60,000 or more, or for the next 12 months is expected to be $60,000 or more
- was less than $60,000, but they include GST in their prices, for example taxi drivers who have included 15% in their taxi fares

CALCULATING GST

Remember that GST is not a cost to a business because any GST that a business pays it gets back from the IRD, and all GST that a business receives it pays to the IRD.

The amount of GST which needs to be calculated depends on the type of product or service being bought or sold.

There are different categories that need to be remembered when calculating GST;

- Standard supplies
- Zero-rates supplies
- Exempt supplies
- Hire purchases
- Standard Supplies

PLEASE NOTE:
GROSS = means the total or whole amount of something.

NETT (or NET) = means what remains from the whole after certain deductions are made.
Source: CFI

Standard Supplies

"Supplies" is **a general term for the goods and services that businesses sell or provide**. Most of these supplies are taxable at 15%. Once the business decides on its selling prices it must add on an additional 15% for GST; this is not profit, it will be collected and passed on to IRD.

GST-Inclusive: when GST is already included in the price

When you have the GROSS cost and want to know how much of it is made up of GST Formula: GROSS COST x 3 / 23 i.e. multiply by 3 and divide by 23 = GST amount

Example:

- A meal in a restaurant cost $120.51
- It is assumed this price includes GST.
  How much is the GST? $120.51 x 3 /23 = 15.72
- The GST is $15.72, and the meal is $104.79
- Check: $104.79 + $15.72 = $120.51

GST-Exclusive: when the price of a good or service does not already include GST. You have to pay the GST on top of the price you see (extra charge).

When you have the NETT cost and want to know how much GST you should add to get the total cost Formula: NETT COST multiplied by 15% = GST

Example:

- A computer costs $3,500, excluding GST
- How much is the GST amount? $3,500 x 15% = 525.00
- The GST is $525.00, so the total cost of the computer including GST is $3,500 + $525.00 = $4025.00

Calculate the GST amount for the following and show your calculations.

GST Inclusive	GST Calculation – Required in full	GST Amount
$90	$90 x 3 / 23	$11.74
$960	$960 x 3 / 23	$125.22
$1,600	$1,600 x 3 / 23	$208.69
$2,000	$2,000 x 3 / 23	$260.87
$27,000	$27,000 x 3 /23	$3,521.74
$120,000	$120,000 x 3 / 23	$15,652.17

GST Exclusive	GST Calculation – Required in full	GST amount to add
$240	$240 x 15% or $240 x 0.15	$36
$800	$800 x 15% or $800 x 0.15	$120
$1,600	$1,600 x 15% or $1,600 x 0.15	$240
$2,000	$2,000 x 15% or $2,000 x 0.15	$300
$18,000	$18,000 x 15% or $18,000 x 0.15	$2,700
$22,500	$22,500 x 15% or $22,500 x 0.15	$3,375

There are certain goods and services that GST is not charged on; these are either zero-rated or exempt from GST.

Zero-Rated Supplies

Zero-rated means that GST is charged at 0%. There are two main examples of zero-rated supplies:

- the sale of a business as a going concern (or land)
- exported goods

Example: Errol Plane lives in Napier. He visits a local travel agent and buys a single air ticket for flights from Napier to Auckland and then on to Perth. GST is charged at 0% on both flights as the travel is considered to be a contract for international carriage.

Exempt Supplies

Exempt supplies are excused from GST; no GST is calculated at all. Some examples of exempt supplies are:

- certain financial services such as bank charges, credit card charges
- wages (includes drawings)
- rent for a private home (domestic rental)
- donated goods supplied by a non-profit organisation

Example: A car dealer donates a car to a church. The church uses the car for two years, and then sells it. The sale of the car is exempt from GST.

Hire Purchases

Hire purchase is a finance option whereby a business can hire a product, such as a computer, by making payments at regular intervals for a specific time usually paying an additional administration fee; once that time is up the business then owns the computer. A business must account for all hire purchase sales in the taxable period covering the date it entered into the agreement, regardless of the accounting basis it uses.

Example: Walter Wall sells a carpet on hire purchase to Homer Ohner on 7 June. The cash price is $550, which includes GST. The agreement is for 36 monthly payments of $23, totalling $828

- 36 months x $23 per month = $828
- $828 - $550 = $278 = finance charge

Walter accounts for the sale on the cash price of the goods ($550) in the period covering 7 June. Homer also claims for his purchase on the cash price of the goods ($550) in the period covering 7 June. The difference of $278 is the finance charge, which is an exempt supply.

1. **For the purposes of GST, say whether the following items are standard supplies (S), zero-rated supplies (Z), or exempt supplies (E). Be able to explain why.**

Sale of a going concern	Z	Office supplies	S
Imported goods	S	Wages	E
Exported goods	Z	Rent paid for office space	S
Computer	S	Rent received for office space	S
Donated goods sold in a charity shop	E	Rent received for private house	E
Capital introduced to the business	E	Car (for business)	S
Flight to London	Z	Bank charges	E
Interest Paid	E	Drawings	E

2. Explain how GST is calculated on hire purchase agreements.

   GST is calculated on the cost price of the item

3. Read the following transactions and calculate the GST where necessary.

Cost of Item / Service / Fees	Standard, Zero-rated or Exempt Supplies? Show calculations
Bought new furniture $2,000	$2,000 x 3/23 = $260.87 Standard
Paid for business rent $450	$450 x 3/23 = $58.70 Standard
Paid banks fees $20	$nil Exempt
Paid business electricity bill $120	$120 x 3/23 = $15.65 Standard
Paid business telephone bill $300	$300 x 3/23 = $39.13 Standard
Sold 10 text Tennis Rackets to a school in Fiji at a price of $79.00 each. The Tennis Rackets were exported to Fiji immediately.	$nil Zero-rated
Banked the weekly sales $1,200	$1200 x 3/23 = $156.52 Standard
Paid for business cleaning $40	$40 x 3/23 = $5.22 Standard
Paid wages of $1,750.	$nil Exempt

ACCOUNTING TO IRD FOR GST

There are two main options used by businesses to pay GST to IRD:

1. Payments Basis

   You need to account for GST in the taxable period in which you make or receive payment. The payments basis is different from the invoice basis as you don't account for debtors and creditors as the end of each taxable period.

   - Advantages
     - The payment basis is suitable for a small business, especially if it currently uses the cash system – cash books can easily be used to account for GST
     - You usually only account for GST when payment is received from the customer – this is to your benefit if you give a lengthy period of credit to customers
   - Disadvantage: You may only claim GST on purchases and expenses after making payment to the supplier

2. Invoice Basis

   You claim GST when you receive or issue an invoice or receive and make a payment, whichever comes first. The invoice basis is similar to the accrual basis of accounting in that adjustments are made at the end of the taxable period for creditors and debtors.

   - Advantage:
     - you may claim GST on purchases and expenses before making payment to the supplier, except for second-hand goods
   - Disadvantages
     - You may have to account for GST before receiving payment
     - You need to keep a list of debtors and creditors at the end of the tax period to account for items for which you've received or issued an invoice but don't appear in your cashbook

GST Return

The GST paid and collected by a business is recorded on a form called a GST Return. All businesses must complete returns on a regular basis and pay the GST owed to IRD. It may be that the business has paid more GST than it collected, if this is the case it will complete the GST return as usual but will instead receive a refund from IRD.

REVISION QUIZ 5

1. GST is different to other taxes as:
   a. Workers pay their taxes as they earn.
   b. It is a tax on goods and services.
   c. It is a sales tax.
   d. It is a tax on exported goods.

2. Businesses must register for GST when:
   a. They made or are projected to make a net profit after tax of $60,000 in a 12-month period
   b. They made or are projected to make a net profit before tax of $60,000 in a 12-month period
   c. They made or are projected to earn revenue of $60,000 or more in a 12-month period
   d. They made or are projected to earn a gross profit of $60,000 or more in a 12-month period

3. What is not a category of GST?
   a. Standard supplies
   b. Hire purchases
   c. Exempt supplies

4. The GST inclusive amount is worked out by:
   a. Multiply nett cost amount by 1.15
   b. Subtract by 1.15%
   c. Divide by 1.15
   d. Add 1.15%

5. GST exclusive amount is worked out by doing what to the gross cost:
   a. Add 3/23
   b. Divide by 3/23
   c. Multiply by 3/23
   d. Subtract 3/23

6. The Payment basis system accounts for GST in the taxable period when:
   a. The business has issued or received an invoice
   b. The business has received an invoice from a supplier
   c. The business has made or received payments
   d. The business has made a payment in cash

7. The Invoice basis system accounts for GST in the taxable period when:
   a. The business has issued or received an invoice, or makes or receives a payment, whichever comes first.
   b. The business has issued or received an invoice and ignores cash payments made or received.
   c. The business issued an invoice only.
   d. The business received an invoice only.

8. In GST the term "Supplies" means:
   a. The materials used to make a product.
   b. Goods and services.
   c. The stock sold by the business.
   d. The tax liabilities of the business.

9. Which is a zero-rated supply?
   a. The sale of a going concern
   b. Imported goods
   c. Wages
   d. Financial services

10. Which is not an exempt supply?
    a. Wages
    b. Rent for a private home
    c. Donated goods to a non-profit organisation
    d. Exported goods

11. GST is paid on the ___________ part of hire purchases:
    a. The principal and interest repayments
    b. The principal repayment
    c. The interest repayment
    d. The interest and administration charges

Check your score: ______ out of 11

TRIAL BALANCE

A trial balance is a summary of all of the accounts as at a particular date. The process of balancing the accounts is an important step in the preparation of financial statements. The trial balance can also be prepared at any time in order to check if any errors have been made when recording the transactions; this is one way to ensure the accuracy of accounting statements.

PLEASE NOTE:
Acc = accounts
Rec = received
Rev = revenue

- Debit balances are put on the left, credit balance on the right
- Based on the accounting equation, if no mistakes have been made in the journals and ledgers the totals of the debit balances should equal the totals of the credit balances
- If they don't match, you must find the mistake and correct it

1. Prepare a trial balance from the following information:

Account	$	→	Trail Balance as at 31 March		
Cash	38,100		Account	Debit	Credit
Land	75,000	Assets	Cash	$38,100	
Wages	619,050		Land	$75,000	
Mortgage	65,000		Furniture	$284,462	
Capital	168,690		Vehicles	$74,190	
Service Rev	1,056,087		Equipment	$32,700	
Advertising	43,600		Acc Rec	$28,085	
Power	14,650	Expenses	Wages	$619,050	
Furniture	284,462		Advertising	$43,600	
Telephone	14,700		Power	$14,650	
Rates	6,750		Telephone	$14,700	
Vehicles	74,190		Rates	$6,750	
Credit Card	2,300		Stationery	$11,250	
Stationery	11,250		Interest expense	$5,400	
Interest expense	5,400		Insurance	$16,800	
Acc Payable	3,210		Rent	$24,000	
Drawings	2,500		Depreciation	$4,050	
Insurance	16,800	Liabilities	Mortgage		$65,000
Rent	24,000		Credit Card		$2,300
Equipment	32,700		Acc payable		$3,210
Depreciation	4,050	Owner's Equity	Capital		$168,690
Acc. Receivable	28,085		Drawings	$2,500	
		Revenue	Service Rev		$1,056,087
				$1,295,287	$1,295,287

Note: the trial balance on the previous page has been prepared by categorising each account into the appropriate accounting element. However, you do not have to use this format. Some companies like to organise the accounts alphabetically, others mix them up. You can prepare it however you like, as long as you get the debits and credits correct!

2. Prepare a trial balance from the following ledger balances of Apu's Tennis Tours at the end of May 2008:

Account	$
Bank	22,933
Van	10,000
Acc. rec	8,864
Purchases	11,287
Rent	900
Bank Fees	15
Phone	370
Wages	765
Stationery	35
Legal Expenses	990
Electricity	114
Insurance	1,975
Acc. payable	12,540
Capital	10,000
Drawings	500
Sales	36,130
Interest Received	78

Account	Debit - $	Credit - $
Bank	22,933	
Van	10,000	
Acc. receivable	8,864	
Purchases	11,287	
Rent	900	
Bank Fees	15	
Phone	370	
Wages	765	
Stationery	35	
Legal Expenses	990	
Electricity	114	
Insurance	1,975	
Acc. Payable		12,540
Capital		10,000
Drawings	500	
Sales		36,130
Interest Received		78
	58748	58748

3. Prepare a trial balance for Sarah's Bike Shop using the following ledger balances at the end of March 2008:

Accounts Receivable	78,790
Accounts Payable	4,700
Drawings	2,200
Bank	85,000
Electricity	5,100
Insurance	2,100
Capital	150,000
Loan	31,152
Revenue	194,202
Inventory	87,000
Prepayments	2,000
Wages	60,000
Rent	24,960
Telephone	3,200
Furniture	8,000
Revenue received in advance	600
Equipment	22,304

	Debit - $	Credit - $
Bank	85,000	
Inventory	87,000	
Prepayments	2,000	
Furniture	8,000	
Equipment	22,304	
Accounts Receivable	78,790	
Electricity	5,100	
Insurance	2,100	
Wages	60,000	
Rent	24,960	
Telephone	3,200	
Accounts Payable		4,700
Loan		31,152
Revenue rec'd in advance		600
Capital		150,000
Drawings	2,200	
Revenue		194,202
	380,654	380,654

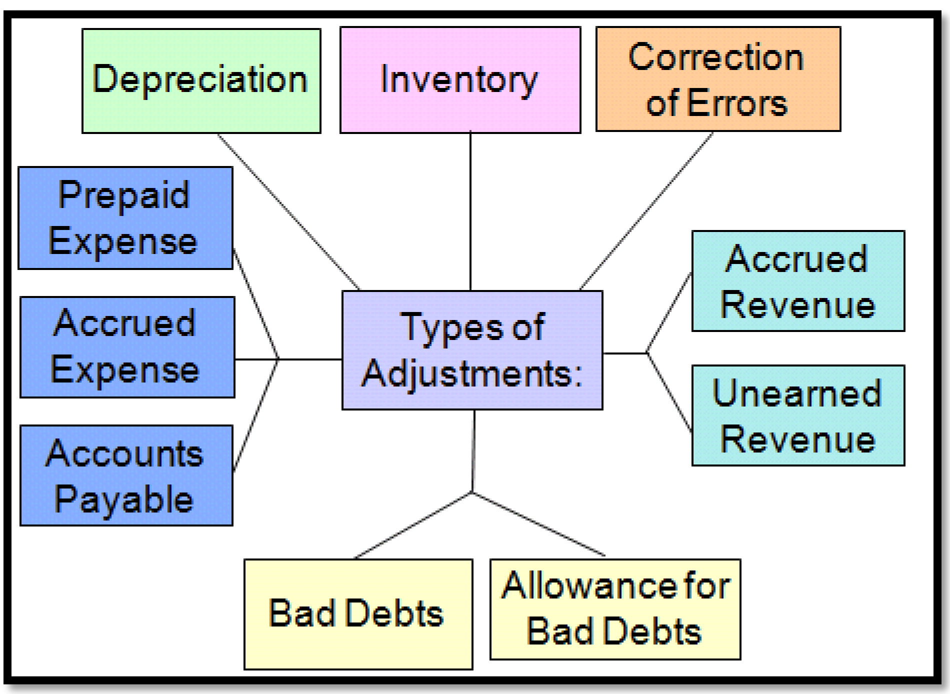
PLEASE NOTE
Advanced Workings
A(283,094) + E(95,360) = 378,454
L(36,452) + OE(147,800) + R(194,202) = 378,454

ADJUSTMENTS

Once a trial balance has been prepared often some adjustments need to be made before financial statements can be prepared. Adjustments are recorded in the general journal; the general ledger is then adjusted, and an adjusted trial balance is prepared.

Adjustments are necessary so as to ensure a proper matching of costs (expenses) with revenue; to ensure there will be a correct calculation of net profit within a specific time period. The correct calculation of net profit is important for decision making; therefore, the measurement of net profit has to be done in accordance with the accounting concepts. All of the business transactions which occur in a particular accounting period need to be recognised, whether cash has been received or paid or not. If adjustments were not made there would not be a true and fair picture of the financial performance of the business. The elements of the accounting equation might be overstated or understated.

Adjustments we will study:



DEPRECIATION

A fixed asset is used by the business to generate future revenue. Its value therefore decreases over time, as its revenue generating power diminishes. Remember, depreciation is a word used to describe the process of spreading the cost of an asset over its useful life to the firm. The cost of the asset is spread over the accounting periods in which it helps to produce income. The Depreciation expense is an attempt to **match this decline in value of an asset** against the revenue earned **during the period** of its useful life (i.e. over time)**.** In fact, **depreciation is an expense** incurred in earning revenue.

PLEASE NOTE

"Depreciation is the method of accounting used to allocate the cost of a fixed asset over its useful life and is used to account for declines in value. It helps companies avoid major losses in the year it purchases the fixed assets by spreading the cost over several years." Source: Freshbooks

Possible reasons for depreciation:

- The expiry of a lease
- Change in technology
- General wear and tear
- Changes in market values

There are different ways to calculate depreciation but for the purposes of our studies, we do not need to learn them. We will just focus on how to record this depreciation in the accounting system.

Example

- Mike's Bike Shop has an asset, a van
- It cost $30,000 when Mike first bought it
- Is it still worth $30,000?
    - No, once the van has been used it begins to lose its value
- A new asset account is called **Accumulated Depreciation** needs to be created along with a new expense account called Depreciation
    - Debit – Depreciation account (expense)
    - Credit – Accumulated Depreciation account (asset)

Record this transaction: machinery was depreciated at a cost of $4,000.

Date	Account	Debit - $	Credit - $
31/03	Depreciation Machinery	4000	
	Accumulated Depreciated		4000
	To record depreciation on machinery		

PLEASE NOTE
This is how much the machinery has depreciated this period; it's not the cost of the machinery

PREPAID EXPENSES (PREPAYMENTS)

These are expenses which have been paid for in the current accounting period but have not been used yet. They will provide benefits in the next accounting period. Something you pay for in advance, you haven't actually used it yet. (It reduces the expense for this accounting year and moves it to next year).

Example of a Prepaid Expense

- Mike owns a bike shop. On 1 January, he pays the annual insurance of $1,200 for the year Jan-Dec. He recorded this transaction as follows:
  - debit – insurance – $1,200 credit – bank – $1,200
- However, his balance date is 31 March. How much insurance has he actually used?
  - $1,200 for one year (12 months), therefore, insurance costs $100 per month
  - If the balance date is March then ¼ belongs to this year (Jan, Feb, Mar is 3 months). This is $100 x 3 months = $300. Mike has only used $300 worth of insurance.
- How much is available for use in the next accounting period?
  - $1,200 - $300 = $900. Mike still has $900 worth of insurance left to use in the next financial period.
- The $900 is a prepayment, which needs to be recorded in a new asset account called Prepaid Insurance. The original entry in the Insurance Expense account needs to be adjusted; the balance needs to be decreased.
  - Debit – Prepaid Insurance account (asset)
  - Credit – Insurance account (expense)

Record this transaction: $1,200 was paid for four months of insurance.
Only one month's worth has been used.

Date	Account	Debit - $	Credit - $
31/03	Prepaid Insurance	900	
	Insurance		900
	To record prepaid insurance		

Calculation:

$1200 / 4 months' = 300. One month has been used = <u>$300</u>.

$1200 - $300 = **$900** (this is the cost for the remaining three months)

ACCRUED EXPENSES OR ACCOUNTS PAYABLE

This is where the business incurs expenses during the accounting period but has not paid them at balance date; a liability.

Examples of an Account Payable (or accrued expense):

- On 31 March, balance day, Mike's Bike Shop wants to record that it has used up one month's worth of telephone expenses. Mike has received the invoice for $90 but **hasn't paid it yet.**

This is just like a normal account payable record

  - Debit – Telephone (expense) Revenues Decrease
  - Credit – Account Payable (liability) Liabilities Increase

- On 31 March, balance day, Mike's Bike Shop wants to record that it has used up one month's worth of electricity expenses. Mike hasn't received the electricity bill yet but **estimates** it to be $120.
  - Debit – Electricity account (expense)
  - Credit – Account Payable/(or Accrued Electricity) (liability)

Record these transactions: Just received the cleaning bill for $200. Haven't received the insurance bill yet but estimate it to be $120.

Date	Account	Debit - $	Credit - $
31/03	Cleaning	200	
	Accrued Cleaning		200
	To record cleaning done – but not yet paid		
31/03	Insurance	120	
	Accrued Insurance		120
	To record insurance used – but not yet paid		

ACCRUED REVENUES

At the end of the year there may be revenue earned by the business that has not yet been received by the balance date. This may happen because an invoice hasn't been prepared yet or a payment hasn't been received. **Accrued revenue is an account receivable; an asset.**

Example of Accrued Revenue

- A customer buys a new bike worth $2,000 from Mike's Bikes Shop
- She does not pay for the bike on the day but promises she will pay next month
- Mike's Bikes made a credit sale, earned the revenue but has not received the money yet
- A new account called Accrued Revenue needs to be created
    - Debit – Accrued Revenue account (asset)
    - Credit – Revenue (revenue)

Record this transaction: sold goods to a customer for $2000. She promises to pay next month.

Date	Account	Debit - $	Credit - $
31/03	Accrued Revenue	2000	
	Revenue		2000
	To record revenue earned – but not yet received		

PLEASE NOTE:
Accrued Revenue is when they have received goods, but they have not invoiced them yet

This transaction can't be recorded until the entire transaction has been completed and the goods have been received

UNEARNED REVENUE

Also called Revenue Received in Advance

Example of Unearned Revenue

- A customer orders a new bike worth $1,500 from Mike's Bike Shop. He pays Mike for the bike, but it will not be delivered until next month. Mike's Bike has received some money which he did not earn yet.
- A new account called Unearned Revenue needs to be created
    - Debit –Revenue (negative income)
    - Credit – Unearned Revenue (liability)

Record this transaction: a customer has paid for 2 months of tour transfers in advance. Tour transfers cost $750 per month.

Date	Account	Debit - $	Credit - $
31/03	Revenue	1500	
	Unearned Revenue		1500
	To record revenue received – but not yet earned		

BAD DEBTS

As we already know, many businesses will make credit sales whereby they allow customers to “buy now, pay later”. These customers are then known as accounts receivable or debtors. Unfortunately, there are times when some customers do not to settle their accounts, i.e. do not pay the money that they owe. The business will do what it can to try to collect the money. It can send reminder letters to the customers, call them, use a debt collection agency or even take legal action.

If the business cannot recover the money, then it loses out on this money; it will never recover it. The specific customer (debtor) is identified, the amount involved is certain and the debt is not collectable. The debt is written off as an expense:

- Debit – Bad Debt account (expense)
- Credit – Accounts Receivable account (reduce asset)

Record this transaction: incurred further bad debts of $2,000 because a customer went bust

Date	Account	Debit - $	Credit - $
31/03	Bad Debts	2000	
	Accounts Receivable		2000
	To record bad debts incurred		

DOUBTFUL DEBTS

In addition to bad debts, some businesses also make allowances for doubtful debts. This means the business will estimate debts that will not be recoverable at the end of each accounting period. This estimate is known as an allowance for doubtful debts. In this situation the specific customer (debtor) is not identified, and the amount involved is estimated, rather than certain.

- The estimation can be made as a percentage of accounts receivable

- alternatively, the business can look at individual debtors and make their estimates based on individual debts which they expect to be unrecoverable
- A combination of both methods can be used; each business has their own way of estimating the doubtful debts

By allowing for doubtful debts the business gets a truer picture of its financial position and performance. In comparison to bad debts, this time the Accounts Receivable account is not credited as the business does not know which customer is involved. Instead, the business must:

- **Debit – Doubtful Debts account (**increased **expense)**
- **Credit – Allowance for Doubtful Debts account (reduce asset -** $40 out of the bank**)**

The figures are estimate throughout the year so at the end of the year, at balance date, an adjustment may need to be made to this estimate.

Example: Accounts Receivable is $12,000 and allowance is to be 2%, i.e. $240

- Suppose an allowance of $200 has already been made in the financials but this is too low; an adjustment of $40 needs to be made ($240 - $200)
  - Debit – Doubtful Debts $40
  - Credit – Allowance for Doubtful Debts $40
- Suppose an allowance of $300 has already been made in the trial balance but this is too high; an adjustment of $60 ($300 - $240) needs to be made
  - Debit – Allowance for Doubtful Debts $60 Extra $ into the bank account
  - Credit – Doubtful Debts $60 Expenses decreased
- Note: GST is not affected in any doubtful debts adjustments.

Record this transaction: allowance for doubtful debts was $500, but it is now estimated to be $662 in total.

Date	Account	Debit - $	Credit - $
31/03	Doubtful Debts	162	
	Allowance for Doubtful Debts		162
	To record adjustment to doubtful debt		

INVENTORY / STOCK

At the end of each accounting period a physical stock take should be completed. This means physically counting and valuing the stock which is left over i.e. has not been sold during the accounting period.

Dealing with inventory at balance date does not require an actual "adjustment" like we have done previously. However, it is important to know how much inventory was on hand at the start of the year and the end of year so that the business can calculate how much inventory was actually sold during the year. These figures will be used in the statement of financial performance later.

The stock is also an asset that the business owns at balance date.

- Debit – Stock in the Balance Sheet (asset)
- Credit – Closing stock in the Profit and Loss Account (reduce expenses)

Read the following transactions, record the adjustments in the general journal. The first one is done for you.

Insurance of $1,350 was paid. This was for 3 months; you have only used 1 month.

Calculation: $1,350 / 3 months' = $450 for 1 month used. $450 x 2 months unused = $900

Date	Account	Debit - $	Credit - $
20/6	Prepaid Insurance	900	
	Insurance		900
	To record insurance prepaid		

Accrued insurance $100

Date	Account	Debit - $	Credit - $
	Insurance (Expense)	100	
	Accrued Insurance (Liability)		100
	To record insurance used but not yet paid		

Rent of $12,000 was paid on 1 January, in advance for a year. Balance day is on 30 June.

Date	Account	Debit - $	Credit - $
	Prepaid Rent (Asset)	6000	
	Rent (Expense)		6000
	To record rent prepaid		

Used advertising worth $4,000 but have not received the invoice yet.

Date	Account		Debit - $	Credit - $
	Advertising (Expense)		4000	
	Accrued Advertising (Liability)			4000
	To record advertising used but not yet paid			

Motor vehicle was depreciated at $2,000

Date	Account	Debit - $	Credit - $
	Depreciation (Expense)	2000	
	Accumulated Depreciation (Asset)		2000
	To record motor vehicle depreciated		

Equipment was depreciated at $500

Date	Account	Debit - $	Credit - $
	Depreciation (Expense)	500	
	Accumulated Depreciation (Asset)		500
	To record equipment depreciated		

Accrued revenue $400

Date	Account	Debit - $	Credit - $
	Accrued Revenue (Asset)	400	
	Revenue (Revenue)		400
	To record revenue earned but not yet received		

Recorded 3,000 revenue but 1,500 was unearned revenue

Date	Account	Debit - $	Credit - $
	Revenue (Revenue)	1500	
	Unearned Revenue (Liability)		1500
	To record revenue received but not yet earned		

Equipment was depreciated at a cost of $1,000

Date	Account	Debit - $	Credit - $
	Depreciation (Expense)	1000	
	Accumulated Depreciation (Asset)		1000
	To record equipment depreciated		

Furniture was depreciated at a cost of $200

Date	Account	Debit - $	Credit - $
	Depreciation (Expense)	200	
	Accumulated Depreciation (Asset)		200
	To record furniture depreciated		

Rent of $1,200 was paid. This was for 4 months'; you have used 2 months.

Date	Account	Debit - $	Credit - $
	Prepaid Rent (Asset)	600	
	Rent (Expense)		600
	To record rent prepaid		

Accrued telephone $200

Date	Account	Debit - $	Credit - $
	Telephone (Expense)	200	
	Accrued Telephone (Creditors/Accounts Payable) (Liability)		200
	To record telephone used but not yet paid		

Accrued revenue $800

Date	Account	Debit - $	Credit - $
	Revenue (Asset)		800
	Accrued Revenue (Revenue)	800	
	To record revenue earned but not yet received		

Recorded $1,000 revenue but 500 was unearned revenue

Date	Account	Debit - $	Credit - $
	Revenue (Revenue)	500	
	Unearned Revenue (Liability)		500
	To record revenue received but not yet earned		

Bad debts were $400

Date	Account	Debit - $	Credit - $
	Bad Debts (Expense)	400	
	Accounts Receivable (Asset)		400
	To record incurred further bad debts		

Allowance for doubtful debts was $400 but it is now estimated to be $350

Date	Account	Debit - $	Credit - $
	Allowance for Doubtful Debts (Asset)	50	
	Doubtful Debts (Expense)		50
	To record adjustment for further doubtful debt		

ADJUSTED TRIAL BALANCE

Once all of the adjustments have been made, an adjusted trial balance needs to be prepared. This is simply the original trial balance plus the adjustments, so there will be some new final balances. It is presented in a document called a 'worksheet'. It is from the adjusted trial balance that the financial statements are prepared.

When adding the trial balance to the adjustments, ensure you take note of whether they are debit or credit entries as this will affect the final answers in terms of whether you add or takeaway the numbers. You add the same entries together and minus the different ones. Look at the examples below:

1. Debit + debit = debit (DR & DR = +)
2. Large debit – credit = larger debit (DR & CR = -)
3. Large credit – debit = larger credit (CR & DR = -)
4. Credit + credit = credit (CR & CR = +)
5. Credit & debit where numbers are the same (they cancel each other out or equal 0)

A 'balance day adjustments worked' example is on the next page.

Joe's Tennis Tours Trial Balance as at 31 March 2010		
	Debit $	Credit $
Bank	28,000	
Inventory @ 1 April 2009	30,000	
Motor Vehicle	24,000	
Acc. Dep on Motor Vehicle (Asset)		4,800
GST		1,000
Loan		9,000
Capital		65,000
Sales		150,340
Purchases	50,000	
Wages	36,000	
Rent	12,000	
Accountancy Fees	1,000	
Interest on Loan	250	
Drawings	48,890	
	230,140	230,140

Adjustments to be made:
(a) money owing from customers $3,600
(b) accounts payable, bought stock $2,700
(c) wages due $1,800
(d) prepaid rent $800
(e) depreciation on motor vehicle $2,400
(f) closing inventory $40,000

Adjustments columns

Trial Balance columns

Key:
Acc = Accumulated
Dep = Depreciation

Joe's Tennis Tours Adjusted Trial Balance as at 31 March 2010						
	Trial Balance		Adjustments		Adjusted Trial Balance	
	Debit $	Credit $	Debit $	Credit $	Debit $	Credit $
Bank	28,000				28,000	
Inventory @ 1 April 2009	30,000				30,000	
Motor Vehicle	24,000				24,000	
Acc Dep on Motor Vehicle		4,800		(e) 2,400		7,200
GST		1,000				1,000
Loan		9,000				9,000
Capital		65,000				65,000
Sales		150,340		(a) 3,600		153,940
Purchases	50,000		(b) 2,700		52,700	
Wages	36,000		(c) 1,800		37,800	
Rent	12,000			(d) 800	11,200	
Accountancy Fees	1,000				1,000	
Interest on Loan	250				250	
Drawings	48,890				48,890	
Accounts Receivable (Asset)			(a) 3,600		3,600	
Accounts Payable (Liability)				(b) 2,700		2,700
Accrued Expenses (Liability)				(c) 1,800		1,800
Prepayments (Asset)			(d) 800		800	
Depreciation - Motor Vehicle (Expense)			(e) 2,400		2,400	
Inventory @ 31 March 2010			(f) 40,000	(f) 40,000	40,000	40,000
	230,140	230,140	51,300	51,300	280,640	280,640

Key: Acc. Dep – Accumulated Depreciation

Note that closing inventory is not an adjustment as such, i.e. for simplicity no figure in the original balance sheet is actually adjusted. Nonetheless, the closing value of closing inventory needs to be recorded (one for the Profit and Loss Account and one for the Balance Sheet).

The following trial balance of Pop's Freedom Tours was prepared as at 31/07/08. Record the necessary adjustments in the general journal and then prepare an adjusted trial balance.

Account	Debit - $	Credit - $
Bank	220,000	
Accounts receivable	400,000	
Stock	5,000	
Furniture and fixtures	75,000	
Acc Dep – fixtures and fittings		30,000
Building	300,000	
Acc Dep – building		150,000
Accounts payable		370,000
Unearned service revenue		30,000
Owner's Equity		300,000
Owners drawings	70,000	
Service revenue		310,000
Salary expense	105,000	
Depreciation – fixtures and fittings		
Depreciation – building		
Miscellaneous expense	15,000	
Total	1,190,000	1,190,000

Key: Acc Dep – Accumulated Depreciation

Stock on hand at end of year was $3,000

The adjustments to be made:

- Depreciation on furniture and fixtures $30,000
- Depreciation on building $8,000
- Salaries owed, not yet paid $4,000
- Accrued service revenue $10,000
- Of the $30,000 balance of unearned revenue, $15,000 was actually earned during the year

General Journal			
	Details	Debit - $	Credit - $
1	Depreciation - Furniture and Fixtures	30,000	
	Accumulated Depreciation Furniture and Fixtures		30,000
	To record depreciation on furniture and fixtures		
2	Depreciation – Building	8,000	
	Accumulated Depreciation Building		8,000
	To record depreciation on building		
3	Salary Expense	4,000	
	Accrued Salary		4,000
	To record salary payable		
4	Accrued Revenue	10,000	
	Service Revenue		10,000
	To record accrued service revenue		
5	Unearned Service Revenue		15000
	Service Revenue	15000	
	To record revenue actually earned		

Trial Balance of Pop's Freedom Tours Ltd as at 31 July 2008						
	Trial Balance		Adjustments		Adjusted Trial Balance	
Account	Debit - $	Credit - $	Debit - $	Credit - $	Debit - $	Credit - $
Bank	220,000				220,000	
Accounts receivable	400,000				400,000	
Stock	5,000				5,000	
Furniture and fixtures	75,000				75,000	
Accumulated depreciation – fixtures and fittings		30,000		(1) 30,000		60,000
Building	300,000				300,000	
Accumulated depreciation – building		150,000		(2) 8,000		158,000
Accounts payable		370,000				370,000
Unearned service revenue		30,000		(5) 15,000		45,000
Owner's Equity		300,000				300,000
Owners drawings	70,000				70,000	
Service revenue		310,000	(5) 15,000	(4) 10,000		305,000
Salary expense	105,000		(3) 4,000		109,000	
Depreciation - fixtures and fittings			(1) 30,000		30,000	
Depreciation - building			(2) 8,000		8,000	
Miscellaneous expense	15,000				15,000	
Accrued salary expense				(3) 4,000		4,000
Accrued service revenue			(4) 10,000		10,000	
Total	1,190,000	1,190,000	0	0	1,242,000	1,242,000

REVISION 6:

1. Identify the accounting element each account belongs to by writing A, E, L, OE or R beside each one.
   Key:
   A – Asset E – Expense L – Liability OE - Owner's Equity R - Revenue

Account	Element
Rent	E
Bank	A
Insurance	E
Account payable	L
Capital	OE
Revenue	R
Account receivable	A
Bank fees	E
Bad debts	E
Unearned revenue	L
Vehicle	A
Drawings	OE
Sales	R
Loan	L
Equipment	A
Doubtful debts	E
Furniture	A
Inventory	A
Rates	E
Electricity	E
Accumulated depreciation	A
Depreciation	E
Account	Element
Accrued expense	L
Accrued revenue	A
Sales	R
Wages	E
Allowance for doubtful debts	A
Prepaid insurance	A

Insert the following calculations for the Adjusted trial balance:

Trial Balance		Adjustments		Adjusted trial Balance	
Debit - $	Credit - $	Debit - $	Credit - $	Debit - $	Credit - $
1000		200		1200	
2000			600	1400	
	500	500		0	
	200		500		700
600		600		1200	
	6300		800		7100
8000			9000		1000
	900		800		1700
700		1000		1700	
	400	800		400	
3000		500		3500	
	7000		500		7500

Note: the column totals DO NOT balance

CLOSING JOURNAL ENTRIES

At the end of the financial year all income and expense ledger accounts are closed off so that they all have zero balances, and the accounts are ready to be used in the next financial year. Under the double-entry system a new ledger account called the trading, or the profit and loss account is created to record the income and expense closing balances. The balance of this account is then transferred to the capital account; drawings would also be closed off at this stage. When each account is closed an entry is also made in the general journal.

Note: the asset and liability accounts are not closed off as there is no need.

The design of the financial statements

(I) Statement of Financial Performance

(II) Statement of Movements in Equity

(III) Statement of Financial Position

The design of the financial statements may have been the personal preference of the accountant who wrote this component.

The majority of the **sub-totals** are usually placed in the second column i.e. expenses. The third column usually contains the totals of the various **sub-sections** in the financial statement.

Other financial statement templates may offer a different design i.e. two columns and not three columns.

Whilst you should not teach specifically to the assessment, it may be better to look at what the assessment requires for this part of the component, to ensure that the method taught is consistent to what the assessment asks students to produce.

The majority of the financial statements should mirror the financial statements that are on page 169.

Also, it may be useful to provide a recap of any financial terms. There may be some new terms in this section that have not been covered before, so it’s a good idea to prep this section before you teach it.

FINANCIAL STATEMENTS

Financial statements are used to communicate the accounting information to the various users. Most users of accounting information are not interested (nor would they understand) the finer details of the accounting system. Instead, they want statements which give them a summary of all the activities of the business.Each type of business entity has their own way of preparing financial statements; we will be focusing on the sole trader entity. **The financial statements outlined below should include the name of the company, name of the statement, and the day / month / year.**

Why? Read Accounting Period Definition: https://bit.ly/3lb8HWr
The following financial statements are prepared for all businesses, for both internal and external users:

- Statement of **Financial Performance** (or a Profit and Loss Account, P&L)
- Statement of **Movements in Equity**
- Statement of **Financial Position** (or a Balance Sheet)

STATEMENT OF FINANCIAL PERFORMANCE

Also called an Income Statement or Profit and Loss account, this is a summary of the transactions of the business within an accounting period in relation to revenue and expenses. The net result is a Profit or Loss which increases or decreases the owner's equity.

Remember, Revenue (or sales) – expenses = profit (or loss). Revenue can be earned from selling goods or providing a service

Classification of Expenses

1. **Cost of goods sold (COGS)** = opening stock (or inventory) + purchases of stock – closing inventory
    - Only applies to business selling physical goods, not services
    - Needs to be subtracted from revenue
    - For instance, if you were operating a travel agency this would be the cost of the tickets being sold (or a supermarket the cost of the cans of baked beans)

    NOTE: you must minus the closing inventory from the equation as you have not sold those items so they cannot contribute toward the cost of goods sold.

2. Selling expenses
    - Expenses incurred in actually making the sales
    - Includes: Sales staff salaries, advertising, commission made on sales, credit card and EFTPOS fees
3. Administration or general expenses
    - All expenses other than selling and finance
    - Includes electricity, insurance, rent, telephone and vehicle expenses
4. Finance expenses
    - Expenses that relate to financing and collecting cash
    - Includes bad and doubtful debts, discount allowed and interest

Each of these expense types will need to be taken away from the revenue to work out the net profit amount. For your assessment, you need to accurately recreate a Financial Performance Statement.

How?

Step 1: learn the 4 expense type headings above

Step 2: Identify which account headings belong to which type of expense

Step 3: Work out the Cost of Goods Sold

Step 4: Take away Cost of Goods Sold from Revenue. Record answer as Gross profit.

Step 5: Add up the subtotals for each of the other types of expenses

Step 6: Add each subtotal and take away that total from the Gross Profit (from step 4)

Step 7: Write down the remaining value as your net profit at the bottom

Example of a sole trader business selling physical goods:

PLEASE NOTE:
What does" Drawings" mean? https://bit.ly/35Fp3lz
What does "Net Surplus" mean? https://bit.ly/2RyvwGD

Accumulated Depreciation is "the total amount a company depreciates its assets. The accumulated depreciation account is a contra asset account on a company's balance sheet, meaning it has a credit balance. It appears on the balance sheet as a reduction from the gross amount of fixed assets reported".
– Source: Investopedia

Jan Browne trading as Guides “R” Us Statement of Financial Performance for year ending 31 March 2008			
	$	$	$
Revenue			317,420
Sales			
Less cost of sales			
Opening inventory	28,906		
Plus purchases	+ 49,936		
Plus Cartage	+ 8,500		
Plus Customs	+ 22,250	= 109,592	
Less closing inventory		- 32,468	
= Cost of goods sold (COGS)			= 77,124
= Gross Profit ($317,420 - $77,124)			240,296
Less Expenses			
Selling Expenses			
Advertising	9,437	9,437	
Administrative Expenses			
Electricity	2,598		
General Expenses	+ 6,096		
Insurance	+ 3,530		
Motor vehicle expenses	+ 4,712		
Office expenses	+ 1,033		
Repairs and maintenance	+ 4,051		
Telephone	+ 2,780		
Wages	+ 93,865	= 118,665	
Finance Expenses			
Doubtful debts	143		
Interest	+ 3,105	= 3,248	
($9,437 + $118,665 + $3,248)			= 131,350
= Net profit (Gross Profit – Expenses)			108,946

Step 3

Step 4

Step 5 & 6

Step 7

PLEASE NOTE:
The **second** column usually states **the sub-totals** i.e. of expenses.

The **third** column contains the totals for each **sub-section** of the statement

PLEASE NOTE:
Definition of "***Cartage***" or "***Cartage In***" is "a charge for transporting goods for short distances, such as within a commercial area or town". Source: Business Dictionary
Example: As our business of supplying food to nearby cafes and restaurants grows, cartage becomes more and more a burgeoning expense
Ensure you discuss **Sales Salaries** (sits under *Selling Expenses*), as it's in the assessment

1. **Put the following items under the correct heading in the statement of financial performance**

Electricity	Inventory (31 March 2016)
Insurance	Rent
Customs Duty	Advertising
Telephone	Inventories (1 April 2017)
Wages	Cartage
Stationery	Depreciation Office Equipment
Bad Debts	Doubtful Debts
Interest	Sales Salaries

Cost of Goods Sold	Selling Expenses	Admin/General Expenses	Financial Expenses
Inventory (31/03/2016) (Opening)	Advertising	Electricity	Bad Debts
Inventories (1/04/2017) (Closing)	Sales Salaries	Insurance	Doubtful Debts
Customs Duty		Telephone	Interest
Cartage (Cost of delivery)		Wages	
		Stationery	
		Rent	
		Depreciation of Office Equipment	

2. How do you calculate the cost of goods sold?

   Cost of goods sold = opening stock (or inventory) + purchases of stock – closing inventory

3. Is the calculation of costs of goods sold necessary for all businesses? Why?

   No. Because not all businesses sell physical goods i.e. inventory will have the costs of goods sold. A business that has service revenue would not have a cost of goods sold.

STATEMENT OF MOVEMENTS IN EQUITY

This statement summarises the changes in owner's equity during the accounting period. For a sole trader this statement is quite straight forward. However, for larger businesses the statement is more complicated.

- The statement of movements in equity begins with the net profit (or loss)
- The contributions from the owner (capital injections) are added and withdrawals (drawings) are subtracted
- Then opening balance of owner's equity from the beginning of the year is added

Jan Browne trading as Guides "R" Us	
Statement of Movements in Equity for the Year Ended 31 March 2009	$
Net profit	86,172
(+) Add contributions	1,033
	87,205
(-) Less withdrawals	58,760
= *(Equals)* Movements in equity	28,445
(+) Add equity at the start of the period	25,292
= *(Equals)* Equity at the end of the period	53,737

STATEMENT OF FINANCIAL POSITION

Also called the balance sheet, this is a summary of the assets, liabilities and owner's equity at the end of a period. It gives a picture of the financial position of the company on a particular date. The assets and liabilities are classified under the headings of current and non-current.

1. **Can you remember what items would come under each heading?**

	Current	Non-Current
Assets	Bank Accounts Receivable Inventory	Land Building / Plant Machinery / Equipment Cars Accumulated Depreciation Computer
Liabilities	Bank Overdraft Accounts Payable	Mortgage Loan

2. Rearrange the following information into a Statement of Financial Position for **ABC Retailers** as at **31 March 2007**.

	$
Loan (10 years)	25,000
Bank overdraft	10,000
Equipment	25,000
Motor vehicles	30,000
Accounts receivable	16,000
Accounts payable	9,000
Inventory	13,000
Owner's Equity	40,000

PLEASE NOTE:
Working Capital is the difference between **current assets and current liabilities**. It shows if the company has enough 'near cash' to meet its financial obligations.

Reminder: **"Capital"** is Owner's Equity

	$	$
Owner's Equity		40,000
As represented by:		
Current Assets		
Accounts Receivable	16,000	
Inventory	13,000	29,000
(-) *Less* **Current Liabilities**		
Accounts Payable	9,000	
Bank O/draft	10,000	19,000
(=) Working Capital (Current Assets – Current Liabilities) ($29,000-$19,000 = $10,000)		10,000
(+) *Add* **Non-Current Assets** (NCA)		
Equipment	25,000	
Motor Vehicles	30,000	55,000
(-) *Less* **Non-Current Liabilities** (NCL)		
Loan		25000
Net Assets = (Working Capital + NCA - NCL)		40,000

PLEASE NOTE:

"**Net Surplus**", "**Contributed Surplus**" or "**Capital Surplus**" is the amount of capital from the issuance of shares above the par value. "Par value" is the face value of a bond. A "bond" is a fixed income instrument that represents a loan made by an investor to a borrower (typically corporate or governmental). A bond could be thought of as an I.O.U. between the lender and borrower that includes the details of the loan and its payments. Bonds are used by companies, municipalities, states, and sovereign governments to finance projects and operations. Source: Investopedia

What Is **Capital Surplus?**

Capital surplus, or share premium, most commonly refers to the surplus resulting after common stock is sold for more than its par value. Capital surplus includes equity or net worth otherwise not classifiable as capital stock or retained earnings. Source: Investopedia

3. Rearrange the following Statement of Financial Position for **Pete's Panel Shop** into the vertical format

Pete's Panel Shop Statement of Financial Position as at 31 December 2016				
Current Assets	$	$	Current Liabilities	$
Bank	6,800		Accounts Payable	2,400
Accounts Receivable	10,000		Non-current Liabilities	
Inventory	20,000	36,800	Mortgage	100,000
Non-Current Assets				
Land	70,000			
Building	105,000		Owner's Equity	150,000
Machinery	20,600			
Car	20,000	215,600		
		252,400		252,400

Pete's Panel Shop **Statement of Financial Position as at 31 December 2016**			
	$	$	$
Owner's Equity			150,000
Current Assets			
Bank		6,800	
Accounts Receivable	10,000		
Inventory $6,800 + $10,000 + $20,000 = **$36,800**		20,000	36,800
(-) Less Current Liabilities			
Accounts Payable		2,400	
(=) Equals Working Capital $36,800 - $2,400 = **$34,400**			34,400
(+) Add Non-Current Assets (NCA)			
Land	70,000		
Building	105,000		
Machinery	20,600		
Car $70,000 + $105,000 + $20,600 + $20,000 = **$215,600**	20,000		215,600
(-) Less Non-Current Liabilities (NCL)			
Mortgage			100,000
Net Assets = (Working Capital + NCA – NCL) $34,400 + $215,600 - $100,000 = **$150,000**			**150,000**

4. There are several errors in the following Statement of Movements in Equity and Statement of Financial Position. Complete the information on the next page using the correct format.

Kiwi Ken's Statement of Financial Position as at 31 December 2016					
	$			$	$
Owner's Equity	100,000		Land		40,000
Loan	40,000		Building	98,000	
Overdraft	13,500		Less Mortgage	45,000	53,000
Net Surplus	4,800		Vehicle	25,000	
Accounts Payable	11,200		Less Accumulated Depreciation	11,500	13,500
			Accounts Receivable		15,000
			Inventory		38,000
			Drawings		10,000
	169,500				169,500

Kiwi Ken's Statement of Financial Position as at 31 December 2016			
	$	$	$
Owner's Equity			100,000
(+) *Add* Net Surplus Contributions	4,800		104,800
(-) *Less* Drawings		10,000	94,800
Represented by:			
Current Assets			
Accounts Receivable	15,000		
Inventory $15,000 + $38,000 = **$53,000**		38,000	53,000
(-) *Less* Current Liabilities			
Accounts Payable		11,200	
Overdraft $11,200 + $13,500 = **$24,700**		13,500	24,700
(=) Working Capital *(Current Assets – Current Liabilities)* $53,000 - $24,700 = **$28,300**			28,300
(+) *Add* Non-Current Assets (NCA)			
Land	40,000		
Building	98,000		
Vehicle	25,000		
(-) *Less* Accumulated Depreciation $40,000 + $98,000 + $25,000 - $11,500 = **$151,500**		11,500	151,500
(-) *Less* Non-Current Liabilities (NCL)			
Mortgage			45,000
Loan			40,000
$45,000 + $40,000 = $85,000			85,000
Net Assets = (Working Capital + NCA - NCL) $28,300 + $151,500 - $85,000 = **$94,800**			**94,800**

Financial Statements and their Relationships

Statement of Financial Performance - Year ended 31.03.09			
	$	$	$
Revenue			317,960
Sales			
(-) Less Cost of Sales			
Opening Inventory	28,906		
(+) Plus Purchases	80,686		
(+) Plus Cartage	250		
(+) Plus Customs	300	110,142	
(-) Less Closing Inventory		32,468	
(=) Cost of Goods Sold			77,674
(=) Gross Profit			240,286
(-) Less Expenses			
Selling Expenses			
Advertising	7437		
Sales staff salaries	2000	9437	
Administrative Expenses			
General Expenses	8,694		
Insurance	3,530		
Motor vehicle expenses	4,712		
Office expenses	1,033		
Printing and stationery	2,374		
Rent	20,400		
Repairs and maintenance	4,051		
Telephone	2,780		
Wages	93,865	141,439	
Finance Expenses			
Doubtful debts	143		
Interest	3,105	3,248	
			154,124
(=) Net Profit (Gross Profit - Expenses)			86,162

Statement of Movements in Equity	
	$
Net profit for the period	86,162
(+) Plus contributions	1,033
	87,195
(-) Less withdrawals	58,760
(=) Movements in equity for the period	28,435
(+) Plus Equity at the start of the period	25,302
(=) Equity at the end of the period	53,737

Statement of Financial Position as at 31.03.09			
	$	$	$
Owner's equity			53,737
As represented by:			
Current Assets			
Bank		4,064	
Accounts receivable	2,860		
(-) Less allowance for doubtful debts	143	2,717	
Inventory		32,468	
Prepaid expenses		680	39,929
(-) Less Current Liabilities			
Accounts payable		6,750	
Unearned revenue		2,000	
Accrued expenses		1,615	10,365
(=) Working Capital			29,564
(+) Plus Non-Current Assets (NCA)			
Computer		3,800	
Beauty therapy equipment at cost	44,000		
(-) Less accumulated depreciation	10,000	34,000	
Motor Vehicle	52,000		
(-) Less accumulated depreciation	23,522	28,478	66,278
(-) Less Non-current liabilities (NCL)			
Loan			42,105
Net Assets = (Working Capital + NCA – NCL)			53,737

These two figures must be the same

For each of the following companies prepare a:

a. Trial balance (if not already provided)
b. Statement of Financial Performance
c. Statement of Movements in Equity
d. Statement of Financial Position

1. **Claire's Cleaning Services (CCS)** had the following general ledger balances as of 31 March 2008:

	$
Accounts Receivable	78,790
Accounts Payable	4,700
Bank	85,000
Owner's Equity @ 01/04/07	150,000
Drawings	2,200
Electricity	5,100
Equipment	22,304
Furniture	8,000
Insurance	2,100
Inventory	87,000
Loan	31,152
Prepayments	2,000
Rent	24,960
Revenue	194,202
Revenue received in advance (Unearned Revenue)	600
Telephone	3,200
Wages	60,000

CCS Trial Balance as at 31 March 2008		
Account	**Debit - $**	**Credit - $**
Accounts Receivable	78,790	
Bank	85,000	
Inventory	87,000	
Equipment	22,304	
Furniture	8,000	
Prepayments	2,000	
Electricity	5,100	
Insurance	2,100	
Rent	24,960	
Telephone	3,200	
Wages	60,000	
Accounts payable		4,700
Loan		31,152
Revenue received in advance (Unearned Revenue)		600
Owner's Equity		150,000
Drawings	2,200	
Revenue		194,202
	380,654	380,654

CCS Statement of Financial Performance for year ending at 31 March 2008			
	$	$	$
Revenue (Or Sales)			194,202
Gross Profit			194,202
(-) *Less* Expenses			
Electricity	5,100		
Insurance	2,100		
Rent	24,960		
Telephone	3,200		
Wages $5,100+ $2,100 + $24,960 + $3,200 + $60,000 = **$95,360**	60,000	95,360	
Net Profit *before tax* = *(Gross Profit – Expenses)* $194,202 - $95,360 = **$98,842**			98,842

CCS Statement of Movement in Equity for year ending 31 March 2008	
	$
Net profit for the period	**98,842**
(+) *Plus* contributions	0
(-) *Less* withdrawals	
Drawings	2,200
(=) Movements in equity for the period	96,642
(+) *Plus* Equity at the start of the period	150,000
(=) Equity at the end of the period	**246,642**

CCS Statement of Financial Position as at 31 March 2008			
	$	$	$
Owner's Equity as of 31/03/08			**246,642**
As represented by:			
Current Assets			
Bank		85,000	
Accounts receivable	78,790		
Inventory		87,000	
Prepaid expenses $85,000 + $78,790 + $87,000 + $2,000 = **$252,790**		2,000	252,790
(-) *Less* Current Liabilities			
Accounts payable		4,700	
Unearned revenue *(received in advance)*		600	5,300
(=) Working Capital *(Current Assets - Current Liabilities)* $252,790 - $5,300 = **$247,490**			247,490
(+) *Plus* Non-Current Assets (NCA)			
Equipment	22,304		
Furniture	8,000	30,304	
(-) *Less* Non-Current Liabilities (NCL)			
Loan			31,152
$30,304 - $31,152 = **-$848**			-848
Net Assets *= (Working Capital + NCA – NCL)* $247,490 + $30,304 - 31,152 = **$246,642**			**246,642**

2. **Graham's Hotel** Adjusted Trial Balance as at 31/03/2017

	Debit - $	Credit - $
Accounts Payable		4,700
Accounts Receivable	70,250	
Accrued Insurance		200
Accrued Revenue	1,000	
Accumulated Depreciation – Equipment		1,800
Accumulated Depreciation – Rooms		8,000
Advertising	4,500	
Bad Debts	2,400	
Bank	75,000	
Guest Sales		194,742
Owner's Equity (1 April 2016)		243,230
Cartage In	746	
Cleaning Expense	9,500	
Customs Duty	476	
Drawings	2,200	
Electricity	5,100	
Equipment	8,000	
Insurance	2,100	
Interest	5,600	
Inventories 1 April 2016)	87,000	
Kennels	45,000	
Land	100,000	
Mortgage		80,000
Prepaid Rent	2,000	
Purchases of food supplies	63,600	
Rates	3,800	
Repairs Expense	9,300	
Revenue Received in Advance		600
Telephone	1,900	
HR Expense	8,800	
Wages	25,000	
	533,272	533,272
Inventory (31 March 2017) $25,000		

PLEASE NOTE:

(I) Statement of Financial Performance

(II) Statement of Movements in Equity

(III) Statement of Financial Position

Graham's Hotel Statement of Financial Performance for year ending 31 March 2017			
	$	$	$
Revenue (from Guest Sales)			194,742
Sales			
(-) Less Cost of Sales			
Opening Inventory	87,000		
(+) *Plus* Purchases of Food Supplies	63,600		
(+) *Plus* Cartage	746		
(+) *Plus* Customs Duty $87,000 + $63,600 + $476 + $746 = **$151,822**	476	151,822	
(-) *Less* Closing Inventory		25,000	
(=) Costs of Sales (Goods Sold) (COGS) $151,822 - $25,000 = **$126,822**			126,822
(=) Gross Profit $194,742 – $126,822 = **$67,920**			67,920
(-) *Less* **Selling Expenses**			
Advertising	4,500	4,500	
Administrative Expenses			
Cleaning expenses	9,500		
Electricity	5,100		
Insurance	2,100		
Rates	3,800		
Repairs expense	9,300		
Telephone	1,900		
HR expense	8,800		
Wages $9,500 + $5,100 + $2,100 + $3,800 + $9,300 + $1,900 + $8,800 + $25,000 = **$65,500**	25,000	65,500	
Financial Expenses			
Interest	5,600		
Bad Debts $5,600 + $2,400 = **$8,000**	2,400	8,000	
$4,500 + $65,500 + $8,000 = **$78,000**			78,000
(=) Net Loss (Gross Profit - Expenses) $67,920 - $78,000 = - **$10,080**			-10,080

PLEASE NOTE: The financial performance results in a **net loss**, rather than a net profit!

Graham’s Hotel Statement of Movement in Equity for year ending 31 March 2017	
	$
Net loss for the period	**- 10,080**
+ contributions	+0
	= - 10,080
- withdrawals	- 2,200
= Movements in Equity for the period	= -12,280
+ Equity at the start of the period (Capital)	+ 243,230
= Equity at the end of the period	**= 230,950**

REMINDER: that instead of a “net profit”, it’s a net loss in this example

Graham’s Hotel Statement of Financial Position year ending 31 March 2017			
	$	$	$
Owner's Equity			230,950
As represented by			
Current Assets			
Bank		75,000	
Acc Rec	70,250		
Inventory		25,000	
Prepaid Rent		2,000	
Accrued Revenue $75,000 + $70,250 + $25,000 + $2000 + $1000 = **$173,250**		1,000	173,250
(-) *Less* **Current Liabilities**			
Acc Payable		4,700	
Revenue received in advance		600	
Accrued Insurance		200	5,500
= Working Capital (Current Assets – Current Liabilities) $173,250 - $5,500 = **$167,750**			167,750
(+) *Add* **Non-current Assets** (NCA)			
Equipment	8,000		
(-) *Less* Accumulated Depreciation	-1,800	6,200	
Kennels	45,000		
(-) *Less* Accumulated Depreciation	-8,000	37,000	
Land $6,200 + $37,000 + $100,000 = **$143,200**		100,000	143,200
(-) *Less* **Non-Current Liabilities** (NCL)			
Mortgage			80,000
Net Assets = (Working Capital + NCA - NCL) $167,750 + $143,200 - $80,000 = **$230,950**			230,950

3. **Kelly's Souvenirs** Adjusted Trial Balance as at 31/03/17

	Debit - $	Credit - $
Accounts Payable		7,480
Accounts Receivable	3,650	
Accumulated Depreciation – Shop Fittings		8,100
Accumulated Depreciation – Vehicle		6,400
Advertising	3,020	
Bad Debts	235	
Bank		3,610
Owner's Equity (1 April 2016)		39,422
Cartage In	2,410	
Customs Duty	2,410	
Delivery Vehicle	35,700	
Depreciation - Vehicle	3,267	
Depreciation - Shop Fittings	900	
Drawings	4,100	
Electricity	2,160	
Insurance	1,110	
Interest	1,300	
Inventories (1 April 2016)	37,400	
Loan		10,000
Prepayments	2,000	
Purchases	89,600	
Rent	18,000	
Sales		200,600
Shop Fittings	21,700	
Sundry Expenses	3,420	
Vehicle Expenses	1,930	
Wages	41,300	
	275,612	275,612
Inventory (31 March 2017) $31,800		

Kelly's Souvenirs Statement of Financial Performance for year ending 31 March 2017			
	$	$	$
Revenue			200,600
Sales			
(-) Less Costs of Sales			
Opening Inventory	37,400		
(+) *Plus* Purchases	89,600		
(+) *Plus* Cartage	2,410		
(+) Plus Customs Duty $37,400 + $89,600 + $2,410 + $2,410 = **$131,820**	2,410	= 131,820	
(-) *Less* Closing Inventory		31,800	
(=) Cost of Sales (Goods Sold) (COGS) $131,820 - $31,800 = **$100,020**			100,020
(=) Gross Profit $200,600 - $100,020 = **$100,580**			100,580
(-) Less **Expenses**			
Selling Expenses			
Advertising	3,200	= 3,020	
Administrative Expenses			
Depreciation - Vehicle	3,267		
Depreciation - Shop Fittings	900		
Electricity	2,160		
Insurance	1,110		
Wages	41,300		
Rent	18,000		
Sundry expenses	3,420		
Vehicle expenses $3,267 + $900 + $2,160 + $1,110 + $41,300 + $18,000 + $3,420 + $1,930 = **$72,087**	1,930	= 72,087	
Financial Expenses			
Bad Debts	235		
Interest $235 + $1,300 = **$1,535**	1,300	= 1,535	
$3,200 + $72,087 + $1,535 = **$76,642**			76,642
(=) Net Profit (Gross Profit - Expenses) $100,580 - $76,642 = **$23,938**			23,938

Kelly's Souvenirs Statement of Movement in Equity for year ending 31 March 2017	
	$
Net Profit for the period	**23,938**
+ contributions	+ 0
	= 23,938
- withdrawals	- 4,100
= Movements in Equity for the period	= 19,838
+ Equity at the start of the period	+ 39,422
= Equity at the end of the period	**= 59,260**

Kelly's Souvenirs Statement of Financial Position for year ending 31 March 2017			
	$	$	$
Owner's Equity			59,260
As represented by			
Current Assets			
Bank		-3,610	
Accounts Receivable	3,650		
Inventory		31,800	
Prepaid expenses -$3,610 + $3650 + $31,800 + $2,000 = **$33,840**		2,000	33,840
(-) *Less* **Current Liabilities**			
Accounts Payable		7,480	
(=) Working Capital $33,840 - $7,480 = **26,360**			26,360
(+) *Add* **Non-Current Assets** (NCA)			
Delivery Vehicle	35,700		
(-) *Less* Accumulated Depreciation	6,400	= 29,300	
Shop Fittings	21,700		
(-) *Less* Accumulated Depreciation $29,300 + $13,600 = **$42,900**	8,100	= 13,600	42,900
(-) *Less* **Non-Current Liabilities** (NCL)			
Loan			10,000
(=) Net Assets = Working Capital + NCA - NCL $26,360 + $42,900 - $10,000 = **$59,260**			59,260

4. **Sun Seeker** Travel Adjusted Trial Balance as at 31 March 2017:

	Debit - $	Credit - $
Accounts Payable		7,320
Accounts Receivable	7,843	
Accrued Expense		100
Accrued Revenue	300	
Accumulated Depreciation – Managers Car		3,200
Advertising	3,500	
Bad Debts	352	
Bank	35,500	
Owner's Equity (1 Apr 2016)		44,563
Cartage In	756	
Car Expense	3,200	
Customs Duty	2,600	
Drawings	2,350	
Electricity	2,400	
Insurance	3,600	
Interest	7,000	
Inventories (1 Apr 2016)	82,000	
Loan		4500
Managers Car	32,000	
Prepayments	1,500	
Purchases	37,200	
Rent	14,000	
Revenue Received in Advance		200
Sales		229,900
Telephone	1,500	
Wages	52,182	
	289,783	289,783
Inventory (31 March 2017) $42,000		

Sun Seeker Travel Statement of Financial Performance for year ending 31 March 2017			
	$	$	$
Revenue			229,900
Sales			
(-) *Less* Cost of Sales (Goods sold)			
Opening Inventory	82,000		
(+) *Plus* Purchases	37,200		
(+) *Plus* Cartage	756		
(+) *Plus* Customs Duty $82,000 + $37,200 + $756 + $2,600 = **$122,556**	2,600	= 122,556	
(-) *Less* Closing Inventory		42,000	
(=) Cost of Goods Sold (COGS) $122,556 - $42,000 = **$80,556**			80,556
(=) Gross Profit $229,900 - $80,556 = **$149,334**			149,344
(-) *Less* **Expenses**			
Selling Expenses			
Advertising	3,500	=3500	
Administrative Expenses			
Electricity	2,400		
Insurance	3,600		
Car Expense	3,200		
Rent	14,000		
Telephone	1,500		
Wages	52,182	=76,882	
Financial Expenses			
Interest	7,000		
Bad Debts $3,500 + $76,882 + $7,352 = **$87,734**	352	=7,352	87,734
(=) Net Profit (Gross Profit – Expenses) $149,344 – $87,734 = **$61,610**			61,610

Sun Seeker Travel Statement of Movement in Equity for year ending 31 March 2017	
	$
Net Profit for the period	**61,610**
+ contributions	+0
	= 61,610
- withdrawals	2,350
= Movements in Equity for the period	= 59,260
+ Equity at the start of the period	+ 44,563
= Equity at the end of the period	**= 103,823**

Sun Seeker Travel Statement of Financial Position for year ending 31 March 2017			
	$	$	$
Owner's Equity			103,823
As represented by:			
Current Assets			
Bank		35,500	
Accounts Receivable	7,843		
Accrued Revenue		300	
Inventory $35,500 + $7,843 + $300 + $1,500 + $42,000 = **$87,143**		42,000	
Prepaid Expenses		1,500	87,143
(-) *Less* **Current Liabilities**			
Accounts Payable		7,320	
Accrued Expense		100	
Revenue received in advance $7,320 + $100 + $200 = **$7,620**		200	7,620
(=) Working Capital $87,143 - $7,620 = **$79,523**			79,523
(+) *Plus* **Non-Current Assets** (NCA)			
Managers Car		32,000	
(-) *Less* **Accumulated Depreciation** $32,000 - $3,200 = **$28,800**		3,200	28,800
(-) *Less* **Non-Current Liabilities** (NCL)			
Loan			4,500
Net Assets = (Working Capital + NCA - NCL) $79,523 + $28,800 - $4,500 = **$103,823**			103,823

5. Here is the adjusted trial balance for **Al's Kayaking,** as at 31 March 2017:

	Debit - $	Credit - $
Accounts Payable		2,100
Accounts Receivable	2,200	
Accrued Expense		60
Accrued Revenue	300	
Accumulated Depreciation – Kayaks		1800
Advertising	3,500	
Bad Debts	20	
Bank	42,300	
Owner's Equity (1 April 2016)		34,563
Cartage In	400	
Window Cleaning Expense	6,000	
Customs Duty	1,800	
Drawings	8,000	
Electricity	1,000	
Insurance	2,400	
Interest	6,500	
Inventories (1 April 2016)	36,000	
Mortgage		55,800
Prepayments	2,800	
Purchases	38,600	
Rates	24,000	
Revenue Received in Advance		50
Sales		198,247
Telephone	4,800	
Kayaks	22,000	
Wages	90,000	
	292,620	292,620
Inventory (31 March 2017) $22,000		

Al’s Kayaking Statement of Financial Performance for year ending 31 March 2017			
	$	$	$
Revenue			198,247
Sales			
(-) *Less* Cost of Sales			
Opening Inventory	36,000		
(+) *Plus* Purchases	38,600		
(+) *Plus* Cartage	400		
(+) *Plus* Customs duty $36,000 + $38,600 + $400 + $1,800 = **$76,800**	1,800	= 76,800	
(-) *Less* Closing Inventory		22,000	
(=) Cost of Goods Sold (COGS) $76,800 = $22,000 = **$54,800**			54,800
(=) Gross Profit $198,247 - $54,800 = **$143,447**			143,447
(-) *Less* Expenses			
Selling Expenses			
Advertising	3,500	3,500	
Administrative Expenses			
Window Cleaning Expenses	6,000		
Electricity	1,000		
Insurance	2,400		
Rates	24,000		
Telephone	4,800		
Wages	90,000	128,200	
Finance Expenses			
Bad Debts	20		
Interest	6,500	6,520	138,220
Net Profit = (Gross Profit - Expenses) $143,447 – $138,220 = **$5,227**			5,227

Al’s Kayaking Statement of Movement in Equity for year ending 31 March 2017	
	$
Net Profit for the period	**5,227**
(+) Plus Contributions	0
	5,227
(-) Less Withdrawals	8,000
(=) Equals Movements in Equity for the period	-2,773
(+) Plus Equity at the start of the period	34,563
(=) Equals Equity at the end of the period	**31,790**

Al's Kayaking Statement of Financial Position for year ending 31 March 2017			
	$	$	$
Owner's Equity			31,790
As represented by:			
Current Assets			
Bank		42,300	
Accounts Receivable	2,200		
Accrued Revenue		300	
Inventory $42,300 + $2,200 + $300 + $22,000 = **$69,600**		22,000	
Prepaid Expenses		2,800	69,600
(-) *Less* **Current Liabilities**			
Accounts Payable		2,100	
Accrued Expense		60	
Revenue received in advance $2,100 + $60 + $50 = **$2,210**		50	2,210
(=) Working Capital $69,600 - $2,210 = **$67,390**			**67,390**
(+) *Plus* **Non-Current Assets** (NCA)			
Vehicle	22,000		
(-) *Less* **Accumulated Depreciation** $22,000 - $1,800 = **$20,200**	1,800	**20,200**	
(-) *Less* **Non-Current Liabilities** (NCL)			
Mortgage			**55,800**
Net Assets = (Working Capital + NCA - NCL) $67,390 + $20,200 - $55,800 = **$31,790**			**31,790**

RATIO FORMATS

Financial analysis involves the use of ratios. Ratios are a mathematical way of expressing the relationship between two numbers. Ratios can be displayed in various different formats.

The most common formats are:

$\frac{1}{2}$ Fractions

0.50 Decimals

50% Percentages

2 : 1 Using the ":" symbol.

This one may be new to you. We say, "2 is to 1".

E.g. there are 2 international students to every 1 domestic student in the class. In other words, there are twice as many international students as there are domestic students.

1. Using your calculator, perform the following calculations and write your answers in the different formats.

$\frac{300}{500}$

Decimal: 0.6

Fraction: 6/10

Percentage: 60%

$\frac{9}{27}$

Decimal: 0.3333333

Fraction: 1/3

Percentage: 33.333333%

2. A cinema sells tickets to adults and children in the ratio of 5 : 3.
   a. What fraction of the tickets were sold to adults?

      There are 8 parts in the ratio (5 +3).
      5/8ths of the tickets are adult, and 3/8ths are children.

   b. The cinema sold 8,000 tickets last week. Approximately how many children's tickets were purchased?

      3/8 x 8,000 = 3,000 (8,000 / 8 then x 3)

3. Divide $1,000 in the ratio of 7 : 13

   There are 20 parts.
   The first person gets 7/20 = 350.
   The second person gets 13/20 = $650.

ROUNDING

When we perform calculations the results we get are often long decimal numbers, for example, 5.6732481. To make the numbers easier to use we will shorten them, so they contain less figures. The process of doing so is known as rounding.

There are many different ways to round numbers, but we will all do it in one particular way so that when we do our calculations, our answers are the same.

We will 'round' to two decimal places, e.g. 5.6732481 is rounded to 5.67

How to round numbers:

- Decide which is the last figure to keep
  - In the above example, if we want to round to two decimal places, the number we want to keep is 7
- Do we need to round? Look at the figure which follows the 7; if it is less than 5, we round down
  - The number after 7 is 3, which is less than 5, so we will not change 7
- If the next figure is 5 or more, we increase it by 1 (round up)

NOTE: If the number is 5, technically you could decide to round up or down. However, so that we are all doing the same thing, we will round up.

1. Round the following numbers to two decimal places.

0.2658974	0.27
22,658.3369874	22,658.34
1.25698	1.26
3.69842	3.70
63.985	63.99
4.523333	4.52

2. Round the following numbers to one decimal place.

0.2658974	0.3
22,658.3369874	22,658.3
1.25698	1.3
3.69842	3.7
63.985	64.0
4.523333	4.5

3. Round the following numbers to whole numbers (no decimal places).

0.2658974	0
22,658.3369874	22,658
1.25698	1
3.69842	4
63.985	64
4.523333	5

RATIO ANALYSIS

Financial ratio analysis is a tool which can be used to find out how a company is performing. The ratios are calculations based on selected values found in the financial statements. It is not really useful to look at one ratio by itself; the best thing to do is carry out many calculations and analyse the results.

Ratios can measure:

1. Profitability
2. Asset utilisation
3. Working capital management
4. Long-term financial stability
5. Financial markets

In the following table, list what items you would expect to find in each financial statement and therefore what ratios (1-4 above) we could calculate from each statement.

Statement	Items	Ratios
Financial Performance (also known as the Income Statement or Profit & Loss Account)	Sales, revenue, cost of goods sold, expenses, gross profit, tax, net profit	1
Movements in Equity	Capital / share capital Drawings Retained earnings	5
Financial Position (also known as the Balance Sheet)	Assets, share capital, current assets, non-current assets, current liabilities, non-current liabilities	2 3 4

http://www.thewarehouse.co.nz/red/menucontent/homepage/investor-centre

THE WAREHOUSE GROUP LIMITED // ANNUAL REPORT 2010

Consolidated Income Statements

FOR THE 52 WEEK PERIOD ENDED 1 AUGUST 2010

	NOTE	(52 WEEKS) GROUP 2010 $ 000	(53 WEEKS) GROUP 2009 $ 000
Revenue		1,672,695	1,720,755
Cost of sales		(1,064,012)	(1,087,375)
Gross profit		608,683	633,380
Other income	6	6,984	6,542
Employee expenses	7	(268,665)	(280,824)
Lease and occupancy expenses	8	(78,330)	(81,664)
Depreciation and amortisation expenses	9	(40,937)	(41,840)
Other operating expenses	10	(103,686)	(110,642)
Operating profit		124,049	124,952
Gain on disposal of property	25	–	315
Changes in fair value of financial instruments	4	(282)	(1,698)
Fresh food and liquor decommissioning costs	12	–	(10,661)
Equity earnings of associate	27	2,808	3,220
Earnings before interest and tax		126,575	116,128
Net interest expense	11	(7,409)	(6,837)
Profit before tax		119,166	109,291
Income tax expense before Government Budget changes	13	(35,590)	(32,295)
Income tax expense relating to Government Budget changes	13	(23,036)	–
Income tax expense		(58,626)	(32,295)
Net profit for the period		60,540	76,996
Attributable to:			
Shareholders of the parent		60,185	76,782
Minority interests	32	355	214
		60,540	76,996
Basic earnings per share	16	19.5 cents	24.9 cents
Diluted earnings per share	16	19.4 cents	24.8 cents
Net assets per share	17	98.0 cents	104.3 cents

Statements of Changes in Equity

FOR THE 52 WEEK PERIOD ENDED 1 AUGUST 2010

GROUP	SHARE CAPITAL $ 000	TREASURY STOCK $ 000	CASH FLOW HEDGE RESERVE $ 000	EMPLOYEE SHARE BENEFITS RESERVE $ 000	RETAINED EARNINGS $ 000	MINORITY INTEREST $ 000	TOTAL EQUITY $ 000
For the 52 week period ended 1 August 2010							
Balance at the beginning of the period	251,445	(14,356)	(20,737)	3,654	100,887	251	321,144
Net profit for the period	–	–	–	–	60,185	355	60,540
Net change in fair value of cash flow hedges	–	–	16,730	–	–	–	16,730
Total comprehensive income	–	–	16,730	–	60,185	355	77,270
Share based payments charged to the income statement	–	–	–	2,609	–	–	2,609
Share rights exercised	–	1,751	–	(2,471)	720	–	–
Shares issued to employee share purchase plan	–	4,355	–	(370)	(1,285)	–	2,700
Dividends paid	–	–	–	–	(101,139)	(266)	(101,405)
Treasury stock dividends received	–	–	–	–	940	–	940
Purchase of treasury stock	–	(12)	–	–	–	–	(12)
Balance at the end of the period	251,445	(8,262)	(4,007)	3,422	60,308	340	303,246
	(note: 30)	(note: 30)	(note: 31)	(note: 31)	(note: 33)	(note: 32)	

Consolidated Balance Sheets

AS AT 1 AUGUST 2010

	NOTE	GROUP 2010 $ 000	GROUP 2009 $ 000
ASSETS			
Current assets			
Cash and cash equivalents	18	**101,226**	52,752
Trade and other receivables	21	**16,929**	24,466
Inventories	19	**254,606**	257,943
Derivative financial instruments	22	**167**	122
Taxation receivable	23	**–**	557
Total current assets		**372,928**	335,840
Non-current assets			
Trade and other receivables	21	**2,091**	–
Property, plant and equipment	25	**272,346**	257,488
Computer software	26	**21,040**	23,192
Investments	27	**5,921**	7,376
Derivative financial instruments	22	**706**	508
Intercompany advances		**–**	–
Deferred taxation	24	**–**	24,844
Total non-current assets		**302,104**	313,408
Total assets	5	**675,032**	649,248
LIABILITIES			
Current liabilities			
Borrowings	29	**75,000**	–
Trade and other payables	20	**120,056**	137,459
Derivative financial instruments	22	**3,586**	27,063
Taxation payable	23	**11,350**	–
Provisions	28	**37,649**	43,939
Total current liabilities		**247,641**	208,461
Non-current liabilities			
Borrowings	29	**98,642**	100,000
Derivative financial instruments	22	**3,269**	3,522
Provisions	28	**16,637**	16,121
Deferred taxation	24	**5,597**	–
Total non-current liabilities		**124,145**	119,643
Total liabilities	5	**371,786**	328,104
Net assets		**303,246**	321,144

EQUITY			
Contributed equity	30	**243,183**	237,089
Reserves	31	**(585)**	(17,083)
Retained earnings	33	**60,308**	100,887
Total equity attributable to shareholders		**302,906**	320,893
Minority interest	32	**340**	251
Total equity		**303,246**	321,144

1. PROFITABILITY RATIOS

What is the company's net return on assets and sales?

These ratios measure how profitable a company is; they are a measure of the company's overall performance. Profitability ratios measure the company's use of its assets and control of its expenses to generate an acceptable rate of return.

Can you remember the difference between gross and net profit?

Gross profit is sales – cost of sales.
Net profit is gross profit – overhead expenses.

Different types of businesses will have different gross and net profit margins depending on the industry and environment they operate in. Here are some examples:

Business Type	Gross Profit	Net Profit
Hotel	9.64%	7.36%
International Airline	5.62%	4.05%
Discount Airline	27.46%	10.87%
Manufacturer	35.14%	-10.48%
Retailer	11.41%	1.63%
Pizza Restaurant	47.52%	7.55%
Computer Software	89.55%	27.15%

(Adapted from http://www.bized.co.uk)

A. GROSS PROFIT PERCENTAGE

Explanation	Gross Profit in relation to sales revenue. It tells us the percentage of sales that are available to cover general expenses and operating costs.
Formula	$\frac{\text{Gross Profit}}{\text{Sales}}$ x 100 (Gross Profit is sales – cost of sales)
Result format	Percentage, e.g. 20% This represents the average gross profit earned on every dollar of sales before we consider operating expenses (and profit).
Comment	The higher the percentage the better. An increase in this ratio over the years implies increased profits; due to an increase in sales or a decrease in the cost of sales and vice versa. We need to look at the statement of financial performance to find out exactly why Gross Profit is high or low.

Reminder to round to **two decimal** places.

1. Calculate the gross profit percentage ratio for The Warehouse Group in 2010.

$$\frac{\text{Gross Profit}}{\text{Sales}} \text{ X } 100 = \frac{608{,}683}{1{,}672{,}695} \text{ X } 100 = 36.39\%$$

2. Calculate the gross profit percentage ratio for The Warehouse Group in 2009.

$$\frac{\text{Gross Profit}}{\text{Sales}} \text{ X } 100 = \frac{633{,}380}{1{,}720{,}755} \text{ X } 100 = 36.81\%$$

3. Compare the results of both years.

   The ratio results are very similar but there was a slight decrease in 2010. Even though revenue decreased a little in 2010, the cost of sales also decreased.

4. If the gross profit figure had stayed the same for the two years how much would the gross profit percentage ratio have changed by? (use the 2009 gross profit figure)

2010

$$\frac{\text{Gross Profit}}{\text{Sales}} \text{ X } 100 = \frac{633{,}380}{1{,}672{,}695} \text{ X } 100 = 37.87\%$$

5. What does the result in question 4 show?

Even though sales decreased (2010), the gross profit percentage increased (very slightly).

B. NET PROFIT PERCENTAGE

Explanation	Tells us the percentage of profit earned on sales, after you subtract the operating expenses
Formula	$\frac{\text{EBIT}}{\text{Sales}} \times 100$ (EBIT means earnings before interest and tax. It is the Gross Profit – expenses; before interest and tax)
Result format	Percentage, e.g. 20% This represents the average profit earned on every dollar of sales after we consider operating costs (excluding interest and tax)
Comment	An increase in this ratio over the years implies increased profits; perhaps due to an increase in Gross Profit or a decrease in operating expenses and vice versa. Again, we need to look at the statement of financial performance to find out exactly why the Net Profit is high or low.

1. Calculate the net profit percentage ratio for The Warehouse Group in 2010.

$$\frac{\text{Net Profit}}{\text{Sales}} \times 100 = \frac{126{,}575}{1{,}672{,}695} \times 100 = 7.57\%$$

2. Calculate the net profit percentage ratio for The Warehouse Group in 2009.

$$\frac{\text{Net Profit}}{\text{Sales}} \times 100 = \frac{116{,}128}{1{,}720{,}755} \times 100 = 6.75\%$$

3. Compare the results of both years.

   The ratio results increased slightly in 2010.

4. If the net profit figure had stayed the same for the two years how much would the net profit percentage ratio have changed by? (use the 2009 net profit figure)

2010 $$\frac{\text{Net Profit}}{\text{Sales}} \times 100 = \frac{116{,}128}{1{,}672{,}695} \times 100 = 6.94\%$$

5. What does the result in question 4 show?

   Even though sales decreased in 2010 the net profit percentage increased.

TIME OUT: COMPARING RESULTS

As we have already learnt, one ratio by itself is not useful. We need to make comparisons to get more information and make sound business decisions. There are two methods we can use for making comparisons. We will briefly look at them now, but you will be using them later when writing your financial reports.

Here is the Statement of Financial Performance (Profit and Loss Account) for the Carphone Warehouse (a telecommunications company in the UK).

Carphone Warehouse Profit and Loss Account for the years ended		
	31 March 2001	25 March 2000
	£'000	£'000
Sales	1,110,678	697,720
Cost of sales	830,126	505,738
Gross profit	280,552	191,982
Operating expenses	176,960	129,359
Operating profit	66,016	41,389
Other costs/income	6,555	-5,132
Net profit	45,012	25,300

Calculate the gross and net profit margins for the years ended 31 March 2000 and 2001.

Ratio	2001	2000
Gross Profit	280,552 ÷ 1,110,678 x 100 25.26%	191,982 ÷ 697,720 x 100 27.52%
Net Profit	45,012 ÷ 1,110,678 x 100 4.05%	25,300 ÷ 697,720 x 100 3.63%

1. **Comparing the same business over a number of years.**

   Looking at the results we can see that the Carphone Warehouse had almost the same profitability results for the two years. This suggests the business is being managed in a stable way. From what we know about the mobile phone industry, i.e. it is constantly changing and growing, we could say this is a good sign as it implies the Carphone Warehouse is stable.

   Are the Carphone Warehouse's ratio results actually good or bad?

   We don't know! We need even more information.

2. **Comparing one business with a similar business in the same industry**

   One way to find out how good or bad the Carphone Warehouse is doing is to compare its ratios with that of another company in the same industry, such as Vodafone.

Ratio	Vodafone 2001
Gross Profit	41.4%
Net Profit	-55.57%

In comparison to the Carphone Warehouse, Vodafone has a higher gross profit margin.

However, when we look at the net profit margin we can see something unusual; Vodafone has made a net loss. To help us find out why this is the case we can look at Vodafone's Statement of Financial performance.

Vodafone Profit and Loss Account for the year ended 31 March 2001		
	£'000	
Sales	15004.0	
Cost of sales	-8702.0	
Gross profit	6302.0	
Operating expenses	-13291.0	
Operating profit	-6989.0	
Other costs/income	80.0	
Net Profit	-6909.0	

Vodafone's operating expenses were very high, and this caused the huge net loss.

So, even though the businesses are in the same industry, they have very different results. On first glance we may have said that Vodafone was more profitable than the Carphone warehouse but on closer analysis we can see that the Carphone Warehouse is actually more profitable.

C. RETURN ON TOTAL ASSETS

Explanation	(also called 'return on investment') Measures the Net Profit after tax as a percentage of the assets employed. It tells us the overall effectiveness of management in using the resources available to the company.
Formula	$\frac{\text{EBIT}}{\text{Total Assets}} \times 100$ (Total assets is simply current assets + noncurrent assets)
Result format	Percentage, e.g. 20% This represents the average profit earned on every dollar of assets the company owns.
Comment	A high ratio implies a higher return on assets. We need to compare this figure to previous years or similar companies to get a meaningful conclusion on whether the result was good or not. We can also compare it to the return on bank deposits (savings) so that we can see where it would be best to invest the money.

1. Calculate the ROTA percentage ratio for The Warehouse Group in 2010.

$$\frac{\text{EBIT}}{\text{Total Assets}} \text{ X } 100 = \frac{126{,}575}{(372{,}928 + 302{,}104)} \text{ X } 100 = \frac{126{,}575}{675{,}032} \text{ X } 100 = 18.75\%$$

2. Calculate the ROTA percentage ratio for The Warehouse Group in 2009.

$$\frac{\text{EBIT}}{\text{Total Assets}} \text{ X } 100 = \frac{116{,}128}{(335{,}840 + 313{,}408)} \text{ X } 100 = \frac{116{,}128}{649{,}248} \text{ X } 100 = 17.89\%$$

3. Compare the results of both years.

The ratio results increased slightly in 2010. This is because the EBIT and the total asset value both increased.

2. ASSET UTILISATION RATIOS

How effectively is the company is using its assets?

These ratios show how much use the company makes of its assets in generating sales. They show whether the company's investments in assets are too big or too small.

If the company has invested too much in assets, it means money is tied up in the assets and not being used as productively as it could be. The company may be making a mistake; it could invest the money more wisely somewhere else.

On the other hand, if the company has not invested enough in assets, then it may be over-using is resources and may not be able to continue meeting customer need. The company may be producing a poor-quality product or providing poor customer service.

INVENTORY TURNOVER

Explanation	Measures the number of times inventory (stock) is turned over during the year, i.e. sold and replaced; this measures the efficiency of inventory management.	
Formula	<u>Cost of Goods Sold</u> Average Inventory (opening + closing inventory / 2)	<u>Number of Days in Year</u> Inventory Turnover
Result format	Times per year	Days
Comment	A high turnover indicates better liquidity. This means less money is tied up in stock and is now free to be spent somewhere else. However, it may also suggest a shortage of inventory needed for sales, which could mean unhappy customers. A low turnover indicates poor liquidity or possible overstocking or obsolete stock.	

A. INVENTORY AFFECTS THE RATIO CALCULATIONS

Sometimes inventory causes problems because it can be difficult to sell or use. For example, even though a supermarket has thousands of people walking through its doors every day, there are still items on its shelves that don't sell as quickly as the supermarket would like. Similarly, there are some items that will sell very well if a business needed to sell some of its inventory to try to cover an emergency, they would be disappointed if it took a long time.

However, how quickly inventory is usually sold depends on the type of business;

- Steel companies can have their materials in stock for as much as 9 months to a year
- Vegetable shops should have stocks for no longer than 4 or 5 days

1. Calculate the Inventory Turnover ratio for The Warehouse Group in 2010.

   Note the closing stock for one year is the opening stock for the next year; closing stock for 2008 was $275,581, therefore this is the 2009 opening stock figure.

$$\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}} = \frac{1{,}064{,}012}{(257{,}943 + 254{,}606)\ /\ 2} = \frac{1{,}064{,}012}{256{,}274.50} = \begin{array}{l}\text{4.15 times}\\ \text{or every 88 days}\end{array}$$

2. Calculate the Inventory Turnover ratio for The Warehouse Group in 2009.

$$\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}} = \frac{1{,}087{,}375}{(275{,}581 + 257{,}943)\ /\ 2} = \begin{array}{c}\text{4.08 times}\\ \text{or every 89.5 days}\end{array}$$

3. Compare the results of both years.

   Turnover decreased slightly in 2010 from 4.08 to 4.15 times. When converted to days the stock turnover decreased by one from 89.5 in 2009 to 88 days in 2010.

B. ACCOUNTS RECEIVABLE TURNOVER

Explanation	Tells us the average time a firm has to wait before it receives cash after making a sale; how long it takes the customers to pay. It measures how good the business's credit, billing and collection procedures are.	
Formula	Annual Sales / Average Accounts Receivable →	Number of Days in Year / Accounts Receivable Turnover
Result format	Times per year	Days
Comment	A high turnover (less days) the more successful the company is in collecting cash from customers. A low turnover (more days) the means customers are taking longer to settle their accounts and it is a sign to the company to reconsider its credit policy because the sooner it can receive the cash the sooner it can use it elsewhere.	

1. Calculate the Accounts Receivable Turnover ratio for The Warehouse Group in 2010.

   "Note: 21 (a) Trade receivables arise from sales made to customers on credit..."

$$\frac{\text{Sales}}{\text{Acc Rec}} = \frac{1{,}672{,}695}{(16{,}929 + 24{,}466\ )\ /\ 2} = \begin{array}{c}\text{80.82 times}\\ \text{or every 4.5 days}\end{array}$$

2. Calculate the Accounts Receivable Turnover ratio for The Warehouse Group in 2009. (The 2008 Accounts Receivable figure was $26,599).

$$\frac{\text{Sales}}{\text{Acc Rec}} = \frac{1{,}720{,}755}{(24{,}466 + 26{,}599)\ /\ 2} = \begin{array}{l}\text{67.4 times}\\ \text{or every 5.4 days}\end{array}$$

3. Compare the results of both years.

   The Accounts Receivable turnover ratio increased slightly in 2010 from 67 to 80 times. In other words the company was waiting 4.5 days to receive payment from customers in 2010 compared to 5.4 days in 2009.

3. WORKING CAPITAL MANAGEMENT RATIOS

Is the company able to meet its short-term (next 2 months) obligations?

Working capital is used to measure the company's short-term liquidity. It tells us how much cash is available to the company to pay its short-term debt, i.e. does it have enough cash resources to pay bills?

Working Capital = current assets – current liabilities

The liquidity of a business is a measure of how it can meet its short-term obligations, i.e. pay loans and creditors. An asset is said to be "liquid" if it can be quickly turned into cash. Liquid assets are current assets, such as cash and accounts receivable.

A. CURRENT RATIO

Explanation	Tells us how well the business can pay its creditors and loans in the next accounting period using its current assets
Formula	<u>Current Assets</u> Current Liability
Result format	x: y
Comment	A ratio of 2: 1 means that for every $1 of liabilities, the firm has $2 in assets, i.e. the firm has two times as many assets as liabilities. A ratio at this level (or above) is considered ideal. A really high ratio would suggest that there are too many assets; they are not being used efficiently. The ratio should be at least 1 : 1 because if the company cannot pay its bills it could become bankrupt. If the ratio result is less than 1:1 the business needs to take action to make an improvement. It could: 1. Increase current assets without increasing current liabilities • The owner could invest more money into the business • A long-term loan could be borrowed from the bank to pay off short-term liabilities 2. Decrease current liabilities • The business could sell some non-current assets to pay off current liabilities If the current ratio increases over the years, it means the company has improved, it had an increase in assets, and it is now in a better position to pay off its debts.

1. Calculate the current ratio for The Warehouse Group in 2010.

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{372{,}928}{247{,}641} = 1.51:1$$

2. Calculate the current ratio for The Warehouse Group in 2009.

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{335{,}840}{208{,}461} = 1.61:1$$

3. Compare the results of both years.

   The current ratio has decreased from 1.61:1 in 2009 to 1.51 : 1 in 2010.

HOW TO IMPROVE WORKING CAPITAL

There are two options;

1. The business must increase current assets
   or
2. The business must decrease current liabilities.

Some actions which can be taken include:

- Increase the gross profit percentage
- Increase the rate of inventory turnover (in the short term the business could have a sale to convert inventories into cash or accounts receivable; in the long term the business could make changes to its product mix)
- Improve the debt collection period (encourage customers to pay quicker)
- Introduce more capital (cash) into the business
- Reduce drawings
- Sell any non-current assets which are not in use
- Sell some non-current assets and then lease them back (a building for example)
- Borrow long-term funds

4. LONG-TERM FINANCIAL STABILITY RATIOS

Is the company able to meet its long-term obligations?

Also known as leverage or debt ratios, they measure the company's long-term solvency, i.e. its ability of the company to meet all its liabilities. They tell us if the company is likely to survive in the long-run. This analysis is used to give a warning of future failure.

A. DEBT TO TOTAL ASSETS

Explanation	Measures the percentage of funds provided by creditors and shows the protection provided by the shareholders for the creditors.
Formula	Total Debt (all liabilities) Total Assets
Result format	%
Comment	A low ratio implies financial stability, therefore, more flexibility to borrow funds in the future. A higher the ratio would not be welcomed by creditors as they would think there is more risk involved.

1. Calculate the Debt to Total Assets ratio for The Warehouse Group in 2010.

$$\frac{\text{Total Debt}}{\text{Total Assets}} \text{ X } 100 = \frac{371{,}786}{675{,}032} \text{ X } 100 = 55.08\%$$

2. Calculate the Debt to Total Assets for The Warehouse Group in 2009.

$$\frac{\text{Total Debt}}{\text{Total Assets}} \text{ X } 100 = \frac{328{,}104}{649{,}248} \text{ X } 100 = 50.54\%$$

3. Compare the results of both years.

The ratio has increased from 50.54% in 2009 to 55.08% in 2010.

B. DEBT TO EQUITY RATIO

Explanation	A measure of a company's financial leverage.
Formula	$\frac{\text{Long-Term Debt}}{\text{Equity (or shareholders' funds)}}$
Result format	%
Comment	A high ratio implies that a large proportion of long-term assets are financed by debt. Long-term creditors prefer to see a low ratio because this implies there is greater protection for them.

1. Calculate the Debt to Equity ratio for The Warehouse Group in 2010.

$$\frac{\text{Long-term Debt}}{\text{Equity}} \times 100 = \frac{124{,}145}{303{,}246} \times 100 = 40.94\%$$

2. Calculate the Debt to Equity for The Warehouse Group in 2009.

$$\frac{\text{Long-term Debt}}{\text{Equity}} \times 100 = \frac{119{,}643}{321{,}144} \times 100 = 37.26\%$$

3. Compare the results of both years.

   The ratio has increased from 37.26% in 2009 to 40.94% in 2010.

5. FINANCIAL MARKETS RATIOS

Is it worth investing in the company?

The results of these ratios are of interest to investors. They give information on the potential risks and returns involved in owning shares in the company.

A. EARNINGS PER SHARE

Explanation	Shows the amount of earnings for each share. This is one of the most important ratios used by investors because they are more interested in their own share of the profit rather than the company as a whole
Formula	$\frac{\text{Net Profit}}{\text{Number of ordinary shares}}$
Result format	Price, e.g. $0.50 per share
Comment	If the earnings per share ratio increase over time, investors will be happy as there are more profits available for them. If profits drop you will notice that the EPS will also drop (unless the number of shares changes).

1. Calculate the EPS ratio for The Warehouse Group in 2010.

   Note on page 80: "Ordinary Shares: The total number of voting securities of the company on issue on 10 September 2010 was 311,195,868 fully paid ordinary shares." This figure has been adjusted to 311,196 to make calculations easier. See also the special note 16(a) on how The Warehouse calculate its EPS (it made a slight adjustment to the ordinary share figure; therefore, our results are not exactly the same).

   $$\frac{\text{Net Profit}}{\text{Number of Ordinary Shares}} = \frac{60{,}540}{311{,}196} = \text{19.5 cents per share}$$

2. Calculate the EPS ratio for The Warehouse Group in 2009.

   $$\frac{\text{Net Profit}}{\text{Number of Ordinary Shares}} = \frac{76{,}996}{311{,}196} = \text{24.8 cents per share}$$

3. Compare the results of both years.

   The EPS has decreased from 24.8 cents in 2009 to 19.5 cents in 2010.

4. What does your comparison in question 4 tell us?

   The decrease indicates the company is performing worse than before. The company would appear to be less profitable to potential shareholders in 2010.

B. PRICE EARNINGS

Explanation	Measures the ratio of the current market price of the ordinary shares to the earnings per share of the ordinary shares. It is a useful ratio for comparing companies.
Formula	$\dfrac{\text{Market Price Per Share}}{\text{Earnings Per Share}}$
Result format	Times, e.g. 5 years
Comment	Because the market price changes from day to day this ratio will also change. For example, if the ratio result is 5 years this means that the investor who wants to buy shares is willing to pay 5 times the price of the earnings per share; prepared to wait 5 years to recover the price of the share. If a company's ratio is higher than its competitors it indicates that investors are expecting profits, dividends and the share price to grow more quickly than the other companies.

1. Calculate the PE ratio for The Warehouse Group in 2010 at a market price of $3.86.

$$\frac{\text{Market Price Per Share}}{\text{Earnings Per Share}} = \frac{3.86}{0.1945} = 19.8 \text{ years}$$

2. Calculate the PE ratio for The Warehouse Group in 2009 at a market price of $3.99.

$$\frac{\text{Market Price Per Share}}{\text{Earnings Per Share}} = \frac{3.99}{0.2474} = 16.1 \text{ years}$$

3. Compare the results of both years.

The EPS has increased from 16.1 years in 2009 to 19.8 years in 2010.

ADDITIONAL RECAP ACTIVITY

Put the following ratios with their correct category and write the formula beside them.

debt to total assets *accounts receivable turnover* *net profit*

debt to equity *gross profit* *price earnings*

quick asset *inventory turnover* *return on total assets earnings per share* *current ratio*

Category	Ratio Name	Formula and Result Format
Profitability	Gross Profit	Gross Profit / Sales %
	Net Profit	EBIT / Sales %
	Return on Total Assets	EBIT / Total Assets %
Asset Management	Inventory Turnover	Cost of Goods Sold / Average Inventory times per year
	Accounts Receivable Turnover	Sales / Accounts Receivable times per year
Working Capital Management	Current Ratio	Current Assets / Current Liabilities x : y
	Quick Asset Ratio (now deleted)	Current Assets – Inventory / Current Liabilities x : y
Long term financial stability	Debt to Total Assets	Total Debt / Total Assets %
	Debt to Equity Ratio	Long-Term Debt / Equity %
Financial Markets	Earnings Per Share	Net profit / Number of Ordinary Shares $0.00 per share
	Price Earning	Market Price Per Share / Earnings Per Share years

Calculate the financial ratios for Autumn Mists Trading Company Ltd.

AMT Company Ltd Statement of Financial Performance for the year ending 31 Dec 2009

Sales			2,000,000
Less Cost of Goods Sold:			
Opening Inventory	150,000		
Purchases	1,450,000	1,600,000	
Less Closing Inventory		200,000	
Cost of Goods Sold			1,400,000
Gross Profit			600,000
Less Expenses:			
Selling		80,000	
Administration		220,000	300,000
Net Profit Before Interest and Tax			300,000
Interest Expense			100,000
Net Profit Before Tax			200,000
Tax			66,000
Net Profit After Tax			134,000

AMT Company Ltd Statement of Movements in Equity for the year ending 31 Dec 2009

Equity:			
Share Capital			300,000
Retained Earnings			200,000
Total Equity			500,000

AMT Company Ltd Statement of Financial Position as at 31 Dec 2009

Total Equity (Owner's Equity)			500,000
Represented By:			
Current Assets			
Bank		240,000	
Accounts receivable	120,000		
Prepayments	40,000		
Inventories		200,000	600,000
Current Liabilities			
Accounts Payable		140,000	
Taxes Payable		20,000	
Accrued Expenses		120,000	280,000
Working Capital			320,000
Non-Current Assets			
Plant and Equipment	550,000		
Accumulated Depreciation	150,000	400,000	
Less Non-Current Liabilities		220,000	180,000
Total Net Assets			500,000

Market price per share $2.25; the share capital is made up of $1 ordinary shares.

Profitability

Ratio	Calculation
Gross Profit	$\frac{\text{Gross Profit}}{\text{Sales}}$ $\frac{600}{2000}$ = 0.3 x 100 = 30%
Net Profit	$\frac{\text{EBIT}}{\text{Sales}}$ $\frac{300}{2000}$ = 0.15 x 100 = 15%
Return on Total Assets	$\frac{\text{EBIT}}{\text{Total Assets (600 + 400)}}$ $\frac{300}{1000}$ = 300 = 0.3 x 100 = 30%

Asset Utilisation

Ratio	Calculation
Inventory Turnover	$\frac{\text{Cost of Goods Sold}}{\text{Average Inventory (150 + 200) / 2}}$ $\frac{1400}{175}$ = $\frac{1400}{175}$ = 8 times per year $\frac{\text{Number of Days in Year}}{\text{ACC Rec Turnover}}$ $\frac{365}{8}$ = 45.6 days
Accounts Receivable Turnover	$\frac{\text{Sales}}{\text{Accounts Receivable}}$ $\frac{2000}{120}$ = 16.7 times per year $\frac{\text{Number of Days in Year}}{\text{ACC Rec Turnover}}$ $\frac{365}{16.7}$ = 21.9 days

Working Capital Management

Ratio	Calculation
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$ $\frac{600}{280}$ = 2.14 : 1

Long Term Financial Stability

Ratio	Calculation
Debt to Total Assets	$\frac{\text{Total Debt}}{\text{Total Assets}}$ $\frac{280 + 220}{1000} = \frac{500}{1000}$ = 0.5 x 100 = 50%
Debt to Equity Ratio	$\frac{\text{Long-term Debt}}{\text{Equity}}$ $\frac{220}{500}$ = 0.44 x 100 = 44%

Financial Markets

Ratio	Calculation
Earnings Per Share	$\frac{\text{Net Profit after Tax}}{\text{Number of Ordinary Shares}}$ $\frac{134}{300}$ = \$0.45 per share The share capital is \$300,000 which is made up of \$1 shares so there are 300,000 shares. Note all the figures are in 000's but to make calculations easier we ignore the 000s.
Price Earnings	$\frac{\text{Market Price Per Share}}{\text{Earnings Per Share}}$ $\frac{2.25}{0.45}$ = 5 years

Calculate the financial ratios for Yummy Chocolates Ltd.

YC Ltd Statement of Financial Performance for the year ended 31 March 2007

Sales			240,000
Less cost of goods sold:			
Opening stock	16,000		
Purchases	80,000	96,000	
Closing stock		12,000	84,000
Gross Profit			156,000
Less Expenses:			
Selling		24,600	
Administration		28,900	
Financial		18,000	71,500
Net Profit Before Tax			84,500
Less tax			25,350
Net Profit After Tax			59,150
Retained earnings brought forward			21,700
			80,850
Less proposed dividend			12,000
Retained earnings carried forward			68,850

YC Ltd Statement of Movements in Equity for the year ended 31 March 2007

Equity:			
Share Capital			86,050
Retained Earnings			68,850
Total Equity			154,900

Statement of Financial Position as at 31 March 2007

Equity			154,900
This is represented by:			
Current Assets			
Bank	67,800		
Accounts receivable	23,000		
Stock	12,000	102,800	
Current Liabilities			
Creditors	15,000		
Taxes payable	4,200		
Proposed Dividends	12,000	31,200	
Working Capital			71,600
Non-current Assets			
Building		31,600	
Equipment		12,000	
Vehicles		25,700	
Furniture and fittings		14,000	83,300
Total Net Assets			154900

Market price per share $1.06; the company has 86,050 $1 shares fully paid

Profitability

Ratio	Calculation
Gross Profit	$\frac{\text{Gross Profit}}{\text{Sales}}$ $\frac{156,000}{240,000}$ = 0.65 x 100 = 65%
Net Profit	$\frac{\text{EBIT}}{\text{Sales}}$ $\frac{84,500}{240,000}$ = 0.35 x 100 = 35%
Return on Total Assets	$\frac{\text{EBIT}}{\text{Total Assets}}$ $\frac{84,500}{186,100}$ = 0.45 x 100 = 45%

Asset Utilisation

Ratio	Calculation
Inventory Turnover	$\frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$ $\frac{84,000}{14,000}$ = 6 times per year $\frac{\text{Number of Days in Year}}{\text{ACC Rec Turnover}}$ $\frac{365}{6}$ = 60.8 days
Accounts Receivable Turnover	$\frac{\text{Annual Sales}}{\text{Accounts Receivable}}$ $\frac{240,000}{23,000}$ = 10.43 times per year $\frac{365}{\text{ACC Receivable Turnover}}$ $\frac{365}{10.43}$ = 35 days

Working Capital Management

Ratio	Calculation
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$ $\frac{102,800}{31,200}$ = 3.29 :1

Long Term Financial Stability

Ratio	Calculation
Debt to Total Assets	$\frac{\text{Total Debt}}{\text{Total Assets}}$ $\frac{31,200}{186,100}$ = 0.17 x 100 = 17%
Debt to Equity	$\frac{\text{Long-term Debt}}{\text{Equity}}$ $\frac{0}{154,900}$ = 0%

Financial Markets

Ratio	Calculation
Earnings Per Share	$\frac{\text{Net Profit}}{\text{Number of Ordinary Shares}}$ $\frac{59,150}{86,050}$ = \$0.69 per share
Price Earnings	$\frac{\text{Market Price Per Share}}{\text{Earnings Per Share}}$ $\frac{1.06}{0.69}$ = 1.5 years

Calculate the financial ratios for Flight Centre for both 2010 and 2009.

Source: http://www3.flightcentre.com.au/corporate/asx/fiscal2010/NWKS44875_FC_Annual_Report_09-10-ONLINE.pdf

Income Statement

	Notes	Consolidated 30 June 2010 $'000	Consolidated 30 June 2009 $'000
Revenue			
Revenue from the sale of travel services	3	1,489,085	1,457,338
Revenue from the sale of travel as principal	3	274,097	225,883
Other revenue	3	32,236	42,141
Total revenue		1,795,418	1,725,362
Cost of travel as principal		(242,433)	(198,615)
Gross profit		1,552,985	1,526,747
Other income	4	4,433	(795)
Expenses			
Selling expenses		(1,066,977)	(1,126,479)
Administration / support expenses		(257,347)	(335,049)
Finance costs	5	(31,967)	(23,190)
Share of profit / (loss) of joint ventures and associates accounted for using the equity method	19	(2,595)	(837)
Profit before income tax expense		198,532	40,397
Income tax expense	7	(58,664)	(2,233)
Profit attributable to members of Flight Centre Limited		139,868	38,164

Statement of Changes in Equity

	Notes	Contributed equity $'000	Reserves $'000	Retained earnings $'000	Total $'000
Balance at 1 July 2008		377,343	(43,626)	269,462	603,179
Total comprehensive income for the year		-	26,303	38,164	64,467
Transactions with owners in their capacity as owners:					
Capital redemption	28	-	10,095	(10,095)	-
Employee Share Plan	27	259	-	-	259
Senior executive Option Plan – share-based payment	28	-	59	-	59
Dividends provided for or paid	8	-	-	(57,275)	(57,275)
Balance at 30 June 2009		377,602	(7,169)	240,256	610,689

	Notes	Contributed equity $'000	Reserves $'000	Retained earnings $'000	Total $'000
Balance at 1 July 2009		**377,602**	**(7,169)**	**240,256**	**610,689**
Total comprehensive income for the year		-	(16,592)	139,868	123,276
Transactions with owners in their capacity as owners:					
Capital redemption	28	-	(20,615)	20,615	-
Employee share plan	27	748	-	-	748
Senior executive Option Plan – exercised	27	581	-	-	581
Senior executive Option Plan – share-based payment	28	-	1,295	-	1,295
Dividends provided for or paid	8	-	-	(25,937)	(25,937)
Balance at 30 June 2010		**378,931**	**(43,081)**	**374,802**	**710,652**

Balance Sheet

Assets	Notes	Consolidated 30 June 2010 $'000	Consolidated 30 June 2009 $'000
Current assets			
Cash and cash equivalents	10	903,329	692,725
Available-for-sale financial assets	12	80,648	77,880
Other financial assets	13	15,474	15,474
Trade and other receivables	11	331,910	234,029
Current tax receivables	14	10,884	11,321
Inventories		1,035	105
Derivative financial instruments	16	1,019	279
Other assets	15	1,264	3,917
Total current assets		1,345,563	1,035,730
Non-current assets			
Property, plant and equipment	17	148,415	177,425
Intangible assets	18	403,948	419,286
Investments accounted for using the equity method	19	15,304	26,648
Deferred tax assets	21	62,151	68,091
Other assets	15	2,928	
Total non-current assets		632,746	691,450
Total assets		1,978,309	1,727,180

Liabilities	Notes	30 June 2010 $'000	30 June 2009 $'000
Current liabilities			
Trade and other payables	22	978,046	908,501
Borrowings	23	93,067	51,590
Provisions	24	10,111	6,922
Current tax liabilities	25	55,457	1,702
Derivative financial instruments	16	935	7,366
Total current liabilities		1,137,616	976,081
Non-current liabilities			
Trade and other payables	22	16,310	22,668
Borrowings	23	84,998	75,968
Provisions	24	17,893	11,662
Deferred tax liabilities	26	10,840	28,381
Derivative financial instruments	16	-	1,731
Total non-current liabilities		130,041	140,410
Total liabilities		1,267,657	1,116,491
Net assets		710,652	610,689
Equity			
Contributed equity	27	378,931	377,602
Reserves	28(b)	(43,081)	(7,169)
Retained profits	28(a)	374,802	240,256
Total equity		710,652	610,689

In 2010 there were 99,780,631 ordinary shares.
In 2009 there were 99,644,038 ordinary shares.
As at 30 June the market price per share was $16.63 in 2010 and $8.65 in 2009.

Profitability

Ratio	Calculation 2010	Calculation 2009
Gross Profit	Gross Profit x 100 Sales 1,552,985 = 86.5% 1,795,418	1,526,747 = 88.49% 1,725,362
Net Profit	EBIT x 100 Sales 198,352 = 11.05% 1,795,418	40,397 = 2.34% 1,725,362
Return on Total Assets	EBIT x 100 = 30% Total Assets 198,352 = 10.03% 1,978,309	40,397 = 2.34% 1,727,180

Asset Utilisation

(Opening stock for 2009 was $1,548; accounts receivable for 2008 were $340,409)

Ratio	Calculation 2010	Calculation 2009
Inventory Turnover	Cost of Goods Sold Average Inventory 242,433 (105 + 1,035)/2 = 425.32 times or every 0.86 days	198,615 (1,548+105)/2 = 240.31 times or every 1.5 days
Accounts Receivable Turnover	Sales Average Accounts Receivable 1,795,418 (331,910 + 234,029)/2 = 6.34 times or every 57.6 days	1,725,362 (234,029 + 340,409)/2 = 6 times or every 60.8 days

Working Capital Management

Ratio	Calculation 2010	Calculation 2009
Current Ratio	Current Assets Current Liabilities 1,345,563 = 1.18 : 1 1,137,616	1,035,730 = 1.06 : 1 976,081

Long Term Financial Stability

Ratio	Calculation 2010	Calculation 2009
Debt to Total Assets	Total Debt x 100 Total Assets 1,267,657 = 64.08% 1,978,309	1,116,491 = 64.64% 1,727,180
Debt to Equity Ratio	Long-term Debt Equity 130,041 = 18.30% 710,652	140,410 = 22.99% 610,689

Financial Markets

Ratio	Calculation 2010	Calculation 2009
Earnings Per Share	Net Profit after Tax Number of Ordinary Shares 139,868 = $1.40 99,781 There were 99,780,631 ordinary shares. This was rounded up to 99,781 to make the calculations easier. Remember net profit after tax is actually 139,868,000	38,164 = $0.38 99,644 There were 99,644,038 ordinary shares but this figure was rounded up.
Price Earnings	Market Price Per Share Earnings Per Share 16.63 = 11.9 years 1.40	8.65 = 22.8 years 0.38