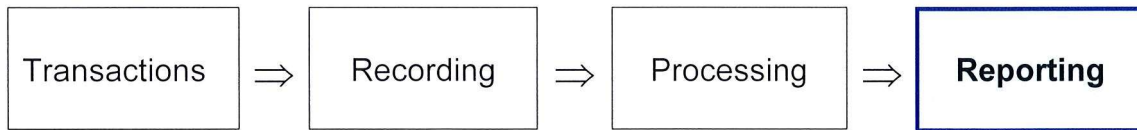


9 Accrual Accounting



Introduction

In this chapter we will examine the preparation of an income statement, for a service business, using accrual accounting

An **income statement** shows the income, expenses and profit or loss of a business for a period of time.

**A Service Business
Income Statement
for the year ended 30 June 2019**

Income	
Less Expenses	
Profit or Loss for the period	

Methods of Profit Calculation

A business can use one of two different methods to calculate its profit or loss. These methods are known as accrual accounting and cash accounting. In this textbook we will focus on the use of accrual accounting. Accrual accounting provides a business owner with more accurate information about the performance and current health of a business than does cash accounting.

Accrual Accounting

Accrual accounting is a method of profit calculation in which:

- income is included in an income statement in the accounting period in which a service is provided or a sale of inventory is made
- an expense is included in an income statement in the accounting period in which the expense is generated.

Example

Dance Tutors is a learn-to-dance school.

Dance Tutors supplied the following information for June 2019:

Fees from students (lessons given in June, money to be received in July)	\$9,000
Wages of teachers paid for 1 to 21 of June	\$4,000
Wages of teachers owing for 22 to 30 of June to be paid in July	\$1,000
Rent paid for June and July (\$900 per month)	\$1,800

Required

Prepare an income statement for the month of June 2019 using **accrual** accounting.

Solution**Step 1**

The income included in the June income statement is the dollar value of the dance lessons given to students in June. It does not matter if the money owing for these lessons has been received or not.

The fees income for June is \$9,000.

Step 2

The expenses generated (or used) in June are included in the June income statement.

The wages expense for June 2019 is calculated as follows:

Wages paid for 1 to 21 June	\$4,000
Wages owing for 22 to 30 June	1,000
Wages expense	\$5,000

Step 2 continued

The \$1,000 of wages **owing** for **22 to 30** of June is an accrued expense.

The accrued wages is a current liability in the balance sheet of 30 June 2019:

Dance Tutors Balance Sheet (extract) as at 30 June 2019	
Current Liabilities	
Accrued Expense	1,000

Step 3

Dance Tutors paid \$1,800 rent for June and July.

The \$900 of rent for **June** is an expense in the June income statement.

The \$900 of rent for **July** is a current asset in the balance sheet of 30 June 2019:

Dance Tutors Balance Sheet (extract) as at 30 June 2019	
Current Assets	
Prepaid Rent	900

Step 4

The income statement is prepared by subtracting the \$5,900 of expenses from the \$9,000 of income. The difference between the income and the expenses is the \$3,100 profit for the year:

Dance Tutors Income Statement (Accrual Accounting) for the month of June 2019		
Fees		9,000
<i>Less Expenses</i>		
Teaching Expenses		
Wages of Teachers	5,000	
Office Expenses		
Rent	900	5,900
Profit for the period		\$3,100

Cash Accounting

Cash accounting is a method of profit calculation in which:

- income is included in an income statement in the accounting period in which **money is received** from a service provided or from a sale
- an expense is included in an income statement in the accounting period in which the expense is **paid**.

Example

Dance Tutors information for June 2019.

Money received from students in June for lessons given in May	\$6,000
Wages of teachers paid for 1 to 21 of June	\$4,000
Rent paid for June and July (\$900 per month)	\$1,800

Required

Prepare an income statement for June 2019 using **cash** accounting.

Dance Tutors Income Statement (Cash Accounting) for the month of June 2019		
Fees		6,000
<i>Less Expenses</i>		
Teaching Expenses		
Wages of Teachers	4,000	
Office Expenses		
Rent	1,800	5,800
Profit for the period		\$200

Only the money received from students in June 2019 is included as income in the June income statement.

Only the expenses paid in June 2019 are included in the June income statement.

The use of cash accounting does not accurately represent the profit made by the business for the month of June 2019.

Questions



Question 1: cash accounting **and** accrual accounting

Question 1

Information supplied by Family Immigration Consultants for August 2024:

Fees	
Money received from customers in August 2024	\$3,000
Services provided to customers in August 2024	7,300
Wages	
Wages paid for 1 to 25 of August	2,900
Wages owing for 26 to 31 of August to be paid in September	600
Electricity	
Electricity bill for July paid in August	700
Electricity consumed in August but not paid until September	400

Required

- 1 Prepare income statements for August 2024 using cash and accrual accounting.

Family Immigration Consultants Income Statement (CASH) for the month of August 2024

Fees		
Less Expenses		
Office Expenses		
Wages		
Electricity		
Loss for the period		

Family Immigration Consultants Income Statement (ACCRUAL) for the month of August 2024

Fees		
Less Expenses		
Office Expenses		
Wages		
Electricity		
Profit for the period		

- 2 Cash accounting is not as accurate as accrual accounting in calculating the profit or loss made by this business because:
 - a some income for August was not included in the calculation of the August profit or loss
 - b some expense for August were not included in the calculation of the August profit or loss
 - c both a and b.



Question 2 onwards: *accrual accounting*

Question 2

Perth Courier Services transactions for **June** 2019:

Fees Income	
• Services provided to customers in June 2019	\$9,000
• Money received from customers in June 2019	7,000

Wages of Drivers	
• Wages paid for 1 to 24 of June	1,300
• Wages owing for 25 to 30 of June to be paid in July	700

Rent of Office	
Rent paid for the months of June and July 2019	2,000

Required

- 1 Prepare an income statement for June 2019 using **accrual accounting**.
- 2 Record the prepaid rent and accrued expenses in the balance sheet on 30 June 2019.

Perth Courier Services Income Statement for the month of June 2019

Fees		
Less Expenses		
Driving Expenses		
Office Expenses		
Profit for the period		

Perth Courier Services Balance Sheet (extract) as at 30 June 2019

Current Assets	
Current Liabilities	

Solution Check

Profit = \$6,000

Question 3

Information supplied by High School Tutors for **March** 2021:

Fees Income	
• Lessons given to students in March 2021	\$3,000
• Money received from students in March 2021	2,000

Wages of Teachers	
• Wages paid for 1 to 26 of March	1,700
• Wages owing for 27 to 31 of March to be paid in April	300

Rent of Office	
Rent paid for the months of March and April 2021	1,600

Required

- 1 Prepare an income statement for March 2021 using accrual accounting.
- 2 Record the prepaid rent and accrued expenses in the balance sheet on 31 March 2021.

**High School Tutors
Income Statement
for the month of March 2021**

Fees		
<i>Less Expenses</i>		
Teaching Expenses		
Office Expenses		
Profit for the period		

**High School Tutors
Balance Sheet (extract)
as at 31 March 2021**

Current Assets	
Current Liabilities	

Solution Check

Profit = \$200

Question 4

Tours of Perth has supplied the following information for June 2024:

Fees	
• Services provided to customers in June 2024	\$8,000
• Money received from customers in June 2024	5,000

Motor Vehicle Insurance	
Insurance paid for the next 12 months	720

Wages of Drivers	
• Wages paid for 1 to 28 of June	3,500
• Wages owing for 29 and 30 of June to be paid in July	200

Required

- 1 Prepare an income statement for June 2024 using accrual accounting.
- 2 Record the prepaid insurance and accrued expenses in the balance sheet on 30 June 2024.

**Tours of Perth
Income Statement
for the month of June 2024**

Fees		
<i>Less Expenses</i>		
Motor Vehicle Expenses		
Profit for the period		

**Tours of Perth
Balance Sheet (extract)
as at 30 June 2024**

Current Assets	
Current Liabilities	

Solution Check

Profit = \$4,240

Question 5

Oz Business College information for June 2022:

Fees	
• Money received from students in June 2022	\$7,300
• Services provided to students in June 2022	8,100

Rent of Office	
Rent paid for June and July 2022	1,400

Wages of Teachers	
• Wages paid for 1 to 24 of June	3,200
• Wages owing for 25 to 30 of June to be paid in July	1,000

Required

- 1 Prepare an income statement for June 2022 accrual accounting.
- 2 Record the prepaid rent and accrued expenses in the balance sheet on 30 June 2022.

**Oz Business College
Income Statement
for the month of June 2022**

Fees		
<i>Less Expenses</i>		
Teaching Expenses		
Wages		
Office Expenses		
Rent		
Profit for the period		

**Oz Business College
Balance Sheet (extract)
as at 30 June 2022**

Current Assets	
Current Liabilities	

Solution Check

Profit = \$3,200

Question 6

Tennis Coaching Services commenced on 1 June 2026. Set out below are the cash inflows and cash outflows of the business for June 2026.

Cash Inflows

Capital	\$11,000	
Fees (services provided in June)	17,400	
GST payable	1,740	30,140

Cash Outflows

Rent (paid for June, July and August)	3,000	
GST credits	300	
Wages of tennis coaches	7,400	10,700

Cash at bank on 30 June 2026		\$19,440
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Additional Information

Wages of tennis coaches owing on 30 June 2026 were \$800.

Required

- 1 Prepare an income statement for June 2026 using accrual accounting.
- 2 Complete the balance sheet extract on 30 June 2026.

**Tennis Coaching Services
Income Statement
for the month of June 2026**

Fees		
<i>Less Expenses</i>		
Coaching Expenses		
Wages		
Office Expenses		
Rent		
Profit for the period		

**Tennis Coaching Services
Balance Sheet (extract)
as at 30 June 2026**

Current Assets	
Cash at Bank	19,440
GST Credits	300
Prepaid Rent	
<i>Total Current Assets</i>	
Current Liabilities	
GST Payable	1,740
Accrued Wages	
<i>Total Current Liabilities</i>	

Solution Check

Profit = \$8,200