

# **FND B020 Accounting**

## **Workbook**

### **Lecture and Tutorial**

#### **Week 1**

**Updated February 2016**

## FND B020 Lecture Week 1 Accounting for Decision Making

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### Learning Outcomes

1. What is Accounting
2. Who uses accounting information
3. Financial Accounting and Management Accounting
4. The Accounting Equation
5. Financial Statements



sibt.nsw.edu.au

navitas.com

### Exercise 1.0

What does accounting mean to you?

Write a few sentences about what you think accounting is, why it is important and who uses it.

## Role of Accounting

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### The Role of Accounting

#### Accounting is an information system

It measures business activity, processes data into reports and communicates results to decision makers.

#### Accounting is the language of business

The better you understand the language, the better you can manage your finances and make informed business decisions



## Users of Accounting Information

### Two Types of Accounting

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#### Management Accounting and Financial Accounting

There are *external* and *internal* users of accounting information. They use information for different purposes.

- **Financial accounting** provides information to decision makers *outside* of the entity such as creditors, regulatory bodies, and the general public investor. *General Purpose* Financial Statements (*GPFS*)
- **Management accounting** is for *internal* decision makers. *Special Purpose* Financial Statements are reports for management for making strategic decisions - budgets, forecasts, sales projections. They help the business remain competitive.

### International Financial Reporting Standards (IFRS)

In Australia, the Australian Accounting Standards Board (AASB) is a government appointed independent accounting body that is responsible for developing accounting standards. The AASB is gradually adopting the International Financial Reporting Standards (IFRS). The IFRS are a set of guidelines that help preparers of financial statements decide how and what financial information is reported by businesses. The set of financial statements are called the General Purpose Financial Statements (GPFS).

This course focuses only on Financial Accounting and General Purpose Financial Statements (GPFS).

### Case Study: Adele's Garden Design business

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Meet Adele ...

Adele loves flowers and gardening. She wants to set up her own garden design business.

What will Adele set up her ...



## Exercise 1.2

### Lists items Adele will need to start her business

Can you think of some business items Adele will need to help start up her Garden Design business?

For each item, decide if it brings future economic benefits to the business and who controls this item.

For student to write down their answers:

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## 7 Definitions

**Assets** are resources **controlled** by the business. They provide **future economic benefit**.

**Liabilities** are **obligations** (amounts owing) of a business to **transfer assets** or **provide services** to another entity. Liabilities are 'outsider claims'.

**Equity** represents the business owner's wealth or interest in the business. Equity also reflects the rights of owners on the business assets.

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## How can Adele finance her new business?

### 1. Use financing

Liabilities are **obligations** (amounts owing) of an entity that will be satisfied through the **transfer of assets** or **provide services** to another entity.

Bank loan (liabilities)

A bank loan is the most common form of long term **borrowing** for a business. A bank loan provides medium or long-term finance. The bank sets the fixed period over which the loan is provided (e.g. 3, 5 or 10 years), the rate of interest and the timing and amount of repayments.

A bank loan is classified as a **non-current** liability as the debt will take *more than a year* to repay.

### Question

Write some reasons why Adele might choose to fund her assets by taking a loan from the bank? Answer:

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**Adele may not have enough cash or savings to start up her business**

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## 2. Buy on credit (buy now, pay later)

Accounts payable (liabilities)

For many businesses, **accounts payable** is an essential tool for financing business growth. Accounts payable is extended to a business by **suppliers** who let you buy *now but pay later*. Any time you take delivery of materials, equipment or other valuable resources (that relate to your *main business operations*) without paying cash on the spot, you are using the “buy now but pay later” facility provided by a supplier. This buy now but pay later is known as ‘accounts payable’. It is classified as a **current** liability that you will be expected to repay in full (fully settled) within 1 year.

### Question

Adele may prefer to purchase items for her business on a ‘buy now - pay later’ basis (accounting term for this is accounts payable)

Write down your understanding of accounts payable. Write some examples of things Adele might buy now but pay for later.

Answer:

**Adele may want to use her supplier’s trade credit facility [or ‘buy now pay later’ facility]. This so if she needs to use the business cash to buy other assets.**

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**For Adele it will be her design garden (e.g. printing equipment, high tech computers or graphic design tablets, AutoCAD (software & annual update support if any), printers for colour printing designs), good quality DSLR Camera, notebooks for jotting ideas, Arts Subscription Magazines**

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## 3. Other payables (liabilities):

These are credit purchases that do not involve ***direct costs to items*** that form part of the goods or services of your business. They are purchases needed to help ***support*** the main operating activities of your business.

**Question**

Can you think of any other payables that Adele may need to help *support* the main operating activities of her Garden Design Business?

Answer:

**electricity payable, office supplies payable, travel cost to client's home,  
occasional overseas travel to help with design ideas, subscription to design  
magazines,**

**insurance on the business car (vehicle)**

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#### 4. Equity (Capital or Owner's Contribution)

When starting a business, the **owners** can contribute funds into the business to finance various asset purchases to be used in the business operations. Adele can choose to contribute at any time during the life of the business. Her first (initial) contribution is usually known as *seed money*.

Important: Owner's contribution is treated as equity and is *completely separate* from any business profits Adele hopes to make after the business starts (commences) operating.

### Accounting Equation: $A = L + E$

### Balancing the Equation

#### 8 The Accounting Equation It must always balance



Assets - Liabilities = Net Assets (Equity)

#### Exercise 1.1

#### Accounting Equation: $A = L + E$

#### Required:

Adele decides to explore different ways of funding her start up business. Below are the possible capital (owner's contribution) scenarios if she decides to fund the business assets from her own savings.

ASSETS	=	LIABILITIES	+	EQUITY
<u>50,000</u>	=	NIL	+	50,000
<u>25,000</u>	=	NIL	+	25,000

Do you see any limitations to owner's contribution if Adele needs to buy more business assets?  
Answer:

**Adele can only purchase assets valued to how much she has contributed in equity. She also needs to keep some extra cash to pay bills.**

**Limited funds may restrict Adele from taking on business opportunities (e.g. missing out on purchasing up-to-date (state of the art) software)**

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Do you see any benefit(s) to owner's contribution if Adele is successful with her small business operations and makes profits without borrowing from lenders (outside parties)?

Answer:

**While Adele may enjoy full control over the business profits she may find it difficult to expand her business if funding is limited.**

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**Required:**

Adele now decides to take a loan and purchase goods on trade credit. Below are the possible scenarios if she has budgeted \$120,000 for the business assets:

Scenario	ASSETS	-	LIABILITIES (borrow from	=	EQUITY (invest as owner) lender)
1	120,000	-	50,000	=	70,000
2	120,000	-	75,000	=	45,000
3	120,000	-	95,000	=	25,000
4	120,000	-	115,000	=	5,000

Do you see any change to Adele's control over the business assets as her borrowing increases? Rearrange the equation to  $A - L = E$  represents her net claim over the business assets after paying off liabilities:

Answer:

**Adele's net claim (or equity) = Assets – Liabilities to the business assets continues to reduce as borrowing increases.**

**Scenario 3 & 4: Adele business is almost fully owned by her lenders!**

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## How Operating Income & Expenses affect Equity

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### The Accounting Equation Equity is made up of 4 activities



#### Question

If the business owner puts (invests) money into the business, is this income? Yes or **No** [it is capital / owner's contribution/ recorded in Equity]

#### Question

Adele as the business owner may also decide to withdraw (take out) assets from the business entity. The withdrawal of assets can be in the form of cash, equipment like a laptop or used car). These 'Drawings' will **reduce** the equity in the business.

Can you think of some reasons why Adele would want to withdraw assets from the business?

Answer:

- Adele may have decided to withdraw cash temporarily for her personal/private use. She can re-contribute to equity later.
- As operating profits improve the business equity improves Adele may want to withdraw cash permanently as a reward for her hard work.
- Drawings in either decision will reduce the business equity
- However, she cannot continue drawing from equity as the business will have no more assets to continue operating.

#### Business operations: Income and expenses

Once Adele has decided on the source of funding (L + E) and made the necessary asset (A) purchases, the business can start to operate. This is reported in the Balance Sheet.

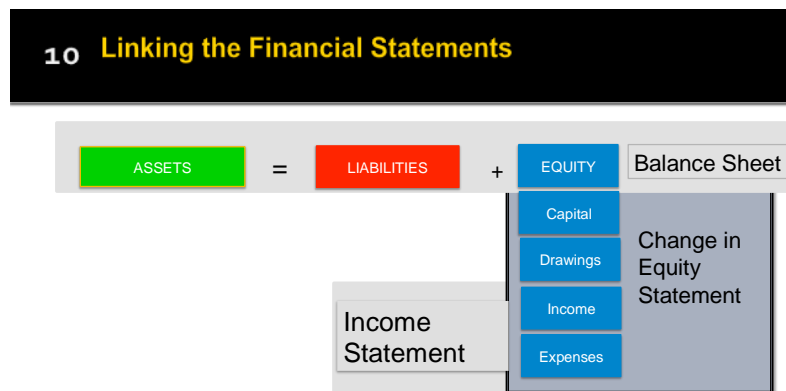
Income is earned as Adele sells design plans to clients. Expenses (costs related to running a business) like purchasing design supplies, paying for electricity and telephone charges will

be incurred. The result of income and expenses is called the **financial performance**. This is reported in the Income Statement. Where income exceeds expenses an operating profit is made by the business. Sometimes, the business may suffer operating losses when income is less than expenses.

**Required:** (choose the most appropriate response)

- Income **improves**/ reduces the Adele's wealth in the business, increasing equity;
- Expenses are costs that improves/**reduces** Adele's wealth in the business; decreasing equity

## Linking the Financial Statements



General purpose financial statements (GPFS) include the:

- Income statement (a report on the business operations or **financial performance**);
- Balance Sheet (a report on the **financial position** or  $A = L + E$ );
- Statement to Changes in Equity (identifies how equity has improved or reduced);
- Statement of Cash Flows

**Note:** Statement of Cash Flows will be taught in ACTG 101 Accounting 1B.

Together, these statements report on the financial effects of transactions and events that have happened in the business.

## Sample Balance Sheet

MINH'S TV REPAIRS	
Balance Sheet	
as at 30 June 2016	
<b>ASSETS</b>	
Cash at bank	\$ 23 165
Accounts receivable	8 895
Repair supplies	7 305
Repair equipment	55 350
Land	30 000
Building	127 500
<b>TOTAL ASSETS</b>	<u>254 220</u>
<b>LIABILITIES</b>	
Accounts payable	10 380
Mortgage payable	100 500
<b>TOTAL LIABILITIES</b>	<u>110 880</u>
<b>NET ASSETS</b>	<u>\$143 340</u>
<b>EQUITY</b>	
Minh Vu, Capital	\$143 340
<b>TOTAL EQUITY</b>	<u>\$143 340</u>

(Source: HEM 9E, p 39)

## Sample Income Statement

MINH'S TV REPAIRS		
Income Statement		
for the year ended 30 June 2016		
<b>INCOME</b>		
Repair income		\$221 250
<b>EXPENSES</b>		
Advertising expense	\$10 125	
Repair supplies expense	45 855	
Salaries and wages expense	63 900	
Rent expense	20 130	
Telephone expense	10 095	
Light and power expense	<u>23 970</u>	
		<u>174 075</u>
<b>PROFIT</b>		<u><u>\$ 47 175</u></u>

(Source: HEM 9E, p 40)

## Sample Statement of Changes in Equity

MINH'S TV REPAIRS	
Statement of Changes in Equity	
for the year ended 30 June 2016	
Minh Vu, Capital — 1 July 2015	\$118 665
Add: Profit for the year	<u>47 175</u>
	165 840
Less: Drawings	<u>22 500</u>
Minh Vu, Capital — 30 June 2016	<u><u>\$143 340</u></u>

(Source: HEM 9E, p 41)

~~~End of Lecture~~~

Tutorial

Week 1

## Accounting Assumptions of GPFS

### Reading T1-A

### Some basic accounting assumption

Message to Tutors: [ **Priority to complete** ]

For each concept there is an example that relates to Adele. Summarise in your own words Take away is:

- Entity concept: Separate and distinguishable. Adele, Capital account is created to record her rights/ownership to be business.
- Accounting period concept: current period/ interim reporting / balance date reporting
  - Accruals accounting: connect this to accounting period, Income Statement (Statement of performance), Use 'time blocking' draw blocks of month-to-month to illustrate prepayments: prepaid expense & unearned revenue.

There are a few important assumptions that form the foundation of general purpose financial reporting. These are the assumption of:

- Entity concept
- Accounting period concept
- Accruals basis
- Going concern

**Entity concept**: a business is considered a separate and distinguishable entity from its owners. It is assumed that each entity controls its assets and incurs its liabilities independent of any private decision(s) made by the business owner. Example: Adele pays for her holiday trip to Bali. This is a decision of a private nature and does not relate to her Garden Design Business. The treatment of a separate entity is why an owner's capital investment is reported as Equity (right of owners to the assets of the business). Equally, when Adele takes out assets from the business it will be reported as Drawings (to recognise that rights of owners in Equity has reduced).

**Accounting period concept**: For financial reporting purposes, the total life of an entity is divided into equal time intervals (e.g. month & year). The use of equal time intervals allows users to *compare* transactions and events affecting the entity over equal periods of time. Example: Adele can compare business operations month-to-month and may discover that income activity is better during the months of December, January, February and March. This will help her plan expenses for those months.

Once a year, the business will need to prepare the GPFS on the last day of the reporting period (**balance date reporting**). This reports the business activities for the entire 12 months to financial year-end. However, preparing **interim** reports (month-to-month before the full financial year) is common. Without interim reporting Adele will be clueless whether her business is making profits or if she needs to further source for funds!

**Accruals basis:** the accruals basis of accounting recognises the effects of transactions and other business events based on the *accounting period concept*. For interim reporting this means:

- the *financial performance* (income and expenses reported in the Income Statement) of the entity can be determined each month. We look at income earned in the current accounting period and match this with expenses incurred over the same period.

If Adele is reporting for the current accounting month of February, income earned can only relate to services performed (rendered) in that month. Example, a client pays her \$5,400 for a 3 month service contract (February, March & April). The interim Income Statement will only report \$1,800 ( $= \$5,400 \div 3 \text{ months}$ ) earned in February. The remaining payment \$3,600 ( $= \$5,400 - \$1,800$ ) will be reported as \$1,800 in each of following months once the service is performed. For February \$3,600 is reported as unearned revenue (although full payment in cash was received).

- In summary, transactions are recognized when they occur (and not as cash is received or paid). This is the accounting period concept of matching income earned and expense incurred in the same accounting period.

Adele may decide to purchase insurance for her business. The insurance company charges her \$2,400 to insure her business for 12 months. If Adele is reporting for the current accounting month of February the expenses for the current month is \$200 ( $= \$2,400 \div 12 \text{ months}$ ). The balance of \$2,200 is reported as prepaid insurance (although fully paid in cash).

**Going concern:** assumes that a business will remain in operations for the foreseeable future. This allows financial reporting to continue to carry forward values recorded in earlier accounting periods. The use of carry forward values applies the *cost principle*. You will learn more about this in the Course: Accounting 1B.

**Problem T1.2**

**Understanding the accounting assumptions**

Message to Tutors:

Socrative online question: **Quiz is “Tutorial 1 Accounting Assumptions”**

The questions/answers are reproduced here just in case first time users are still in their learning phase.

Encourage students to use a pseudonym (alternate name) and keep the name throughout. This will allow them to chart their performance.

Required:

**For the following questions, log on to Socrative.com and complete the questions online to receive your answers.**

1. The Entity Concept states that a business that is separate and distinct from its owners.

**True / False**

Explanation/Answers:

**For accounting purposes, an entity is considered as a separate and distinct business.**

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2. Wei Lin is reporting for the current accounting period of February. A client pays (cash received) \$4,500 for on a 3 month service contract. Wei Lin records \$4,500 as income in February. Income is correctly reported.

**True/ False**

Explanation/Answers:

**Wei Lin should only report income earned in February. Accruals accounting recognises \$1,500 as income and the remaining \$3,000 as**



**unearned revenue; a liability to perform services for the next two accounting periods.**

3. Receiving a bill or being notified that an amount is owed in the current accounting period is not recorded until the amount is paid (i.e. cash is paid).

True / False

Explanation/Answers:

**Accruals accounting identifies income and expenses relating to the same accounting period. If the amount is owed in the current accounting period should be recognised as an expense.**

~~~Next topic~~~

## Classifying the types of accounts:

### 10 Classifying types of accounts

Transactions and classified into relating to elements in a  
• Income and Expenses  
• Assets, Liabilities and Balance Equity  
Income Statement reports on performance  
Balance Sheet reports position or  
how these funds

Workbook Exercise



### Problem T1.3

### Classifying financial events into the types of accounts

Message to Tutors: [ **Priority to complete** ]

Aim: to help students differentiate Income Statement & Balance Sheet items. The glossary below is to help them understand what is current accounting period items:

- Do not go through the glossary to pick out key points;
- Clarify that Income & Expense items are recorded in the Income Statement not Balance Sheet. It is the net result reported ie. Net Income that is 'transferred' into equity.

Classify the financial transactions into broad classes or elements in the correct financial statements.

***Required:***

The following financial items apply to "Management Services" for 30.6.2015. Read the meaning of each item and consider whether each item applies to the current accounting period (income and expense items) or will continue to be present for more than one accounting period (asset, liability and equity).

Now classify (✓) the following as Asset (A), Liability (L), Income (I), Expense (E), Capital (C) or Drawings (D).

Classify the following items in the correct financial statement with a (✓): **Answers**

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| Income Statement         |         |   |   | Balance Sheet |     |                 |   |
|--------------------------|---------|---|---|---------------|-----|-----------------|---|
|                          |         |   |   | A             | = L | + Equity        |   |
| Items                    | \$      | I | E | A             | L   | C               | D |
| Cash at bank             | 33,500  |   |   | ✓             |     |                 |   |
| Mortgage                 | 75,000  |   |   |               | ✓   |                 |   |
| Accounts receivable      | 23,000  |   |   | ✓             |     |                 |   |
| Accounts payable         | 14,000  |   |   |               | ✓   |                 |   |
| Drawings                 | 4,200   |   |   |               |     |                 | ✓ |
| Supplies                 | 2,000   |   |   | ✓             |     |                 |   |
| Telephone payable        | 450     |   |   |               | ✓   |                 |   |
| Prepaid rent             | 3,600   |   |   | ✓             |     |                 |   |
| Equipment                | 45,000  |   |   | ✓             |     |                 |   |
| Building                 | 120,000 |   |   | ✓             |     |                 |   |
| Unearned income          | 15,000  |   |   |               | ✓   |                 |   |
| Rent expense             | 1,000   |   | ✓ |               |     | Equity reduces  |   |
| Wages expense            | 5,600   |   | ✓ |               |     | Equity reduces  |   |
| Wages payable            | 2,610   |   |   |               | ✓   |                 |   |
| Capital ,opening balance | 86,850  |   |   |               |     | ✓               |   |
| Telephone expense        | 650     |   | ✓ |               |     | Equity reduces  |   |
| Service income           | 45,700  | ✓ |   |               |     | Equity improves |   |
| Interest income          | 290     | ✓ |   |               |     | Equity improves |   |
| Advertising expense      | 1,350   |   | ✓ |               |     |                 |   |

### Glossary

Use the following definitions to help you classify account names.

| Items               | Meaning   |
|---------------------|---|
| Cash at bank        | currency and coins owned by the business. Cash can be exchanged for another business asset or used to reduce liabilities (e.g. pay bills).                  |
| Mortgage            | a loan (source of funding) to the business. It is a debt that must be repaid in the future.   |
| Accounts receivable | amounts due from customers for sale of goods or services performed on credit. Sale to customer was on 'sell now but collect later'.                         |
| Accounts payable    | amounts owed to creditors for the purchase of merchandise, supplies and services in the normal course of business. Purchase was on 'buy now but pay later'. |
| Drawings            | the withdrawal of assets from the business entity by its owner(s)   |
| Supplies            | Merchandise, supplies and services available for sale or use in the normal course of business. Supplies are used over more than one                         |

|  |  |
|--|--|
|  |  |
|  | <b>Student Workbook: Week 1</b>  |
|  | accounting period and will have future economic benefits expected to flow to the entity.   |
| Telephone payable  | “payable” are purchases on “buy now but pay later”. This is an amount that will continue to be payable (owed) until the debt is settled.   |
| Prepaid rent   | “ <u>prepaid</u> expenses (prepayments)” or purchases of amounts that will provide economic benefits for more than the <i>current accounting period</i> . – e.g. prepaid for the next 6 months.  |
| Equipment  | any tools or machinery that will be used in normal course of business usually for more than the <i>current accounting period</i> .   |
| Building an asset (e.g. factory, office building, warehouse) | controlled by the business as a result of past events (purchased) and from which future economic benefits are expected to flow to the entity.  |
| Unearned income  | “Unearned”. The business may have received payment (cash) of amounts for delivery of goods or performance of in advance but should only record income when the service is provided to the client during <i>each accounting period</i> .<br>– e.g. client pays for 6 months of delivery service in February |
| Rent expense   | ‘Expense’. This is rental paid for the use of an asset business does not own. Expense means that the cost is for the current accounting period.<br>– e.g. rent for the month for the use of office space;<br>– expense does not mean that it has been paid (cash);   |
| Wages expense  | ‘Expense’. This is wages to employees incurred in the current accounting period.   |
| Wages payable  | “payable” is wages that is owing to employees where the business has not yet paid. ‘Payable’ will remain a debt as long as it is not paid.   |
| Opening Capital  | Investment contributed by the owner into the business recorded as a right of the owner over the business assets.   |
| Telephone expense  | ‘Expense’. A telephone bill for service charges for the current accounting period.   |
| Service income   | “income” earned from the customer for services provided in the current accounting period.  |
| Interest income  | “income” earned from business investments (other than service income) in the current accounting period.  |
| Advertising expense  | ‘Expense’. Advertising charges for the current accounting period.  |

**Problem T1.4**
**Identify the type of accounts that will affect the balance sheet**

(source: Problem 3.1 Hoggett, 8e)

Message to Tutors:

**Optional depending on time. Revisit to complete if time permits.**

Listed below are the ledger accounts of Kathleen's Catering Services:

- |                             |                                 |
|-----------------------------|---------------------------------|
| 1. Cash at Bank             | 14. Electricity Account Payable |
| 2. Land                     | 15. Service Fee Revenue         |
| 3. Wage Expense             | 16. Interest Receivable         |
| 4. Kathleen Watts, Drawings | 17. Wages Payable               |
| 5. Sundry Revenue           | 18. Prepaid Insurance           |
| 6. Buildings                | 19. Accounts Payable            |
| 7. Mortgage Payable         | 20. Maintenance Equipment       |
| 8. Interest Revenue         | 21. Unearned Revenue            |
| 9. Accounts Receivable      | 22. Kathleen Watts, Capital     |
| 10. Supplies Used           | 23. Interest Expense            |
| 12. Insurance Expense       | 11. Loan Payable                |
| Hand 26.                    | 24. Rent                        |
|                             | 13. Supplies on                 |

### KATHLEEN'S CATERING SERVICE

**Required:**

*For each account listed below, complete the form as shown below by placing a tick in the proper columns to indicate (i) the type of account each belong to, or (i) if the income or expense affects the equity account.*

|         | Type of Account |           |   |
|---------|-----------------|-----------|---|
|         | A = L + E       |           |   |
| Account | Asset           | Liability | Equity<br>(Income improves equity)<br>(Expenses reduces equity) |

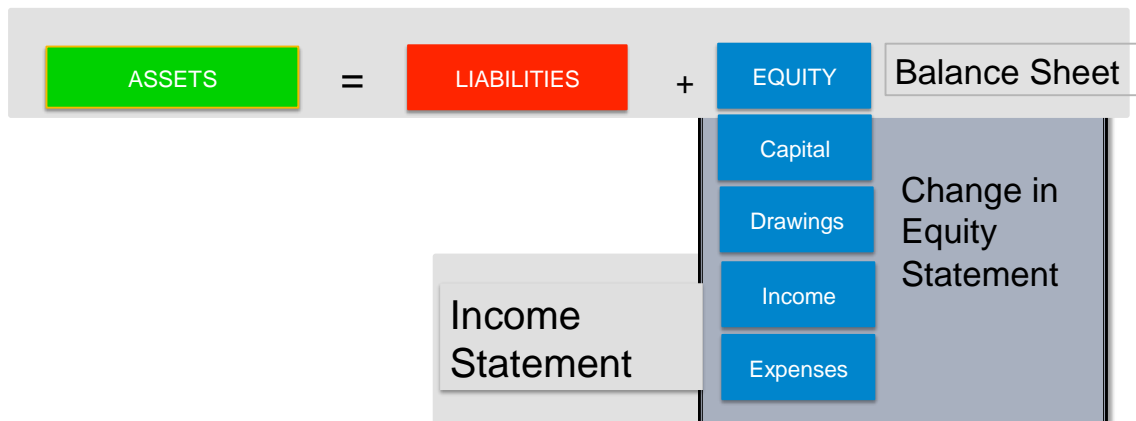
**Student Workbook: Week 1**

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|                                |   |   |   |
|--------------------------------|---|---|---|
| 1. Cash at Bank                | ✓ |   |   |
| 2. Land                        | ✓ |   |   |
| 3. Wage Expense                |   |   | ✓ |
| 4. Kathleen Watts,<br>Drawings |   |   | ✓ |
|                                |   |   |   |
| 5. Sundry Revenue              |   |   | ✓ |
| 6. Buildings                   | ✓ |   |   |
| 7. Mortgage Payable            |   | ✓ |   |
| 8. Interest Revenue            |   |   | ✓ |
| 9. Accounts Receivable         | ✓ |   |   |
| 10. Supplies Used              |   |   | ✓ |
| 11. Loan Payable               |   | ✓ |   |
| 12. Insurance Expense          |   |   | ✓ |
| 13. Supplies on Hand           | ✓ |   |   |
| 14. Electricity Acc Payable.   |   | ✓ |   |
| 15. Service Fee Revenue        |   |   | ✓ |
| 16. Interest Receivable        | ✓ |   |   |
| 17. Wages Payable              |   | ✓ |   |
| 18. Prepaid Insurance          | ✓ |   |   |
| 19. Accounts Payable           |   | ✓ |   |
| 20. Maintenance Equipment      | ✓ |   |   |
| 21. Unearned Revenue           |   | ✓ |   |
| 22. Kathleen Watts, Capital    |   |   | ✓ |
| 23. Interest Expense           |   |   | ✓ |
| 24. Rent Revenue               |   |   | ✓ |

## Linking the Financial Statements

### 10 Linking the Financial Statements



#### Problem T1.5

#### Adele's Garden Design:

**Change in Equity = Capital – Drawings + (Income – Expense)**

Message to Tutors: **[PRIORITY TO COMPLETE]**

AIM: Changes in Equity (Lecture slide as a teaching aid):

- more to explain to students how Net Income/Loss affects owner's wealth (equity);
- Answers in red are to be filled in by students

Adele has given a summary of the business operations for three months (i.e. 3 interim accounting periods):

| Month         | Income   | Expense  | = | Net Income / Net Loss |
|---------------|----------|----------|---|-----------------------|
| February 2016 | \$15,000 | \$7,000  | = | <b>\$8,000</b>        |
| March 2016    | \$17,000 | \$13,000 | = | <b>\$4,000</b>        |
| April 2016    | \$16,700 | \$18,700 | = | <b>(\$2,000)</b>      |

Use this information to complete the following exercises:

1. Adele decides to start her Garden Design business with a paid-in capital of \$100,000. For the first financial period the business makes a net **income of \$8,000**. She decides to keep all of the net income to help her business. What is the equity in Garden Design as at the end of 1<sup>st</sup> financial period?

Statement of Changes in Equity for the period  
ended \_\_\_\_\_

|                                |         |
|--------------------------------|---------|
| Opening balance:               | Nil     |
| Paid-In-Capital (seed capital) | 100,000 |
| Add: Net Income / Loss         | 8,000   |
| Less: Drawings                 | -       |
| Closing balance                | 108,000 |

2. For the 2nd financial period the business makes a net **income of \$4,000**. Adele decides to withdraw \$50,000 for her private use. What is the equity in Garden Designs as at the end of 2nd financial period?

Statement of Changes in Equity for the period ended  
\_\_\_\_\_

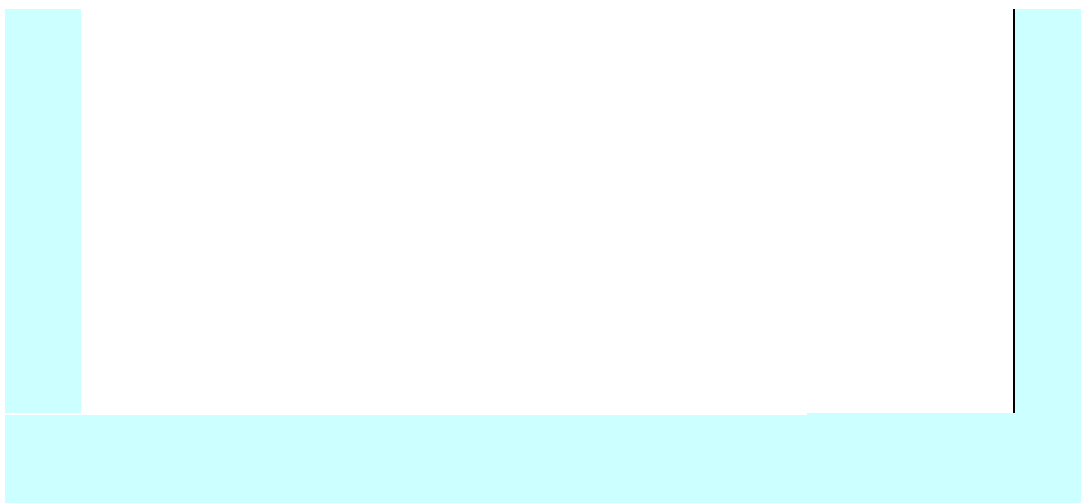


|                              |                 |
|------------------------------|-----------------|
| Opening balance (from _____) | <b>108,000</b>  |
| Add: Net Income / Loss       | <b>4,000</b>    |
| Less: Drawings               | <b>(50,000)</b> |
| Closing Balance              | <b>62,000</b>   |

3. For the 3rd financial period the business makes a net **loss of \$2,000**. Adele withdraws \$20,000 for her private use. She then decided to invest \$30,000. What is the equity in Garden Design as at the end of 3rd financial period?

Statement of Changes in Equity for the period ended

|                              |                 |
|------------------------------|-----------------|
| Opening balance (from _____) | <b>62,000</b>   |
| Add: Paid-In-Capital         | <b>30,000</b>   |
| Add: Net Income/Loss         | <b>(2,000)</b>  |
| Less: Drawings               | <b>(20,000)</b> |
| Closing Balance              | <b>70,000</b>   |



**Problem T1.6**

**Determining Profit from Equity Balances**

(source: Hoggett, 8e)

Message to Tutors:

**Optional depending on time. Revisit to complete if time permits.**

*Equity balances for Richard Burke appearing in the balance sheets of Burke's Financial Services **as at** 30 June 2016, 2015 and 2014 are set out below:*

|                           | 30 June<br>2016 | 30 June<br>2015 | 30 June<br>2014 |
|---------------------------|-----------------|-----------------|-----------------|
| EQUITY                    |                 |                 |                 |
| Richard Burke,<br>Capital | \$136,500       | \$150,000       | \$140,000       |

*During 2015–16, Burke withdrew \$100 000 for personal use and also contributed additional capital of 45 000. During 2014–15, he withdrew \$30 000 capital from the business, and withdrew \$90 000 cash for his own use in anticipation of profits.*

Note:

(During 2015-2016 – Financial year from 1 July 2015 to 30 June 2016; and  
(During 2014-2015 – Financial year from 1 July 2014 to 30 June 2015)

*Required*

*Determine the profit/loss earned by the business in each of the 2 years ended 30 June 2016 and 30 June 2015.*

**BURKE'S FINANCIAL SERVICES**

| BURKE'S FINANCIAL SERVICES         |           |                |
|------------------------------------|-----------|----------------|
| Profit for years ended 30 June     | 2015      | 2016           |
| Beginning Capital                  | \$140 000 | \$150 000      |
| + Additional Capital Contributions | -         | 45 000         |
| - Withdrawals of Capital           | (30 000)  | -              |
| - Drawings                         | (90 000)  | (100 000)      |
| <b>Profit</b>                      | <b>?</b>  | <b>130 000</b> |
| Ending Capital                     | \$150 000 | \$136 500      |

## Classifying Assets, Liabilities & Equity in the Balance Sheet:

Message to Tutors: **[TOP PRIORITY TO COMPLETE]**

AIM: Due to lecture time constraints this topic is covered in Tutorials. Please complete.

- Current & non-current Balance Sheet layout.
- $A = L + E$  :

Current Assets: : Assets that will be used up or converted into cash within the shortterm, i.e. < 1 year.

e.g. cash, debtors, inventory , investment (short-term)

Non-current Assets : Assets acquired with the intention that they be held for the purpose of earning revenue,

- i.e. they assist the business in the process of generating revenue for more than one accounting period. e.g. land, buildings, equipment, vehicles,

- investment (long-term)

Non-current assets may be further classified into *two* sub-groups (for Accounting 1A):

- Property Plant & Equipment - e.g. land, buildings, equipment, (Fixed Assets) vehicles, machinery, etc

|  |   |
|--|---|
|  | <b>Student Workbook: Week 1</b>                         |
|  | – Investments - e.g. term deposits, shares, bonds, etc. |

|                         |   |
|-------------------------|---|
| Current Liabilities     | Commitments (debts e.g. creditors, loans (short-term)) the business must meet on demand or at short notice, i.e. < 1 year. This usually           |
|                         | necessitates the use of existing current assets to pay off the debts.   |
| Non-current Liabilities | Commitments which have to be met (paid) after the expiration of the next operating cycle/period, i.e. > 1 year. e.g. mortgage, loans (long-term). |

### Equity:

The owner's entitlement in the business/entity. It includes capital and accumulated profits. CAPITAL is the owner's contribution or investment in the business.

$$\text{Assets} - \text{Liabilities} = (\text{Net Assets}) = \text{Equity}$$

|                     |  |
|---------------------|--|
| <b>Problem T1.6</b> | <b>Classifying Assets, Liabilities &amp; Equity in the Balance Sheet</b> |
|---------------------|--|

(source: PIBT 1999, pg 27)

“You have just enrolled in an accounting course with SIBT. Renee your good friend is starting a hairdressing business called “Hair Care” and has asked for your help:

Renee would now like to apply for a further loan with the CBA Bank. The bank loans officer has asked her to determine how much her current business investment is worth? She does not understand how to present her financial information and has asked you for help”.

Required

Take a few minutes to decide how to present the financial information to CBA Bank.

On 30 June 2017 Renee has the following items:

Classify the items as Assets (CA , NCA) and Liabilities (CL, NCL)

## Student Workbook: Week 1

|  | Classify                     | \$      |
|--|------------------------------|---------|
| Hair Dryers                                  | <b>Non-current asset</b>     | 4 200   |
| Loan from CBA Bank to purchase her home      | <b>Private use</b>           | 250 000 |
| Other Equipment                              | <b>Non-current asset</b>     | 1 800   |
| Owed to Napri Ltd for Shampoo & Perm Lotions | <b>Current liability</b>     | 80      |
| Renee's annual health insurance              | <b>Private use</b>           | 350     |
| Bank account "Hair Care"                     | <b>Current asset</b>         | 1080    |
| Loan from CBA Bank to purchase hair dryers   | <b>Non-current liability</b> | 1000    |
| Fixtures and Fittings                        | <b>Non-current asset</b>     | 1000    |

List the ASSETS:

|       |       |                            |
|-------|-------|----------------------------|
| Total | 8,080 | Cash at Bank               |
|       |       | <b>1,080 current asset</b> |

List the LIABILITIES:

|                       |                    |                          |                  |              |
|-----------------------|--------------------|--------------------------|------------------|--------------|
|                       | <b>1,800</b>       | <b>non-current asset</b> | Hair Dryers      | <b>4,200</b> |
|                       |                    |                          | Other Equipment  |              |
| Fixtures and Fittings | <b>1,000</b>       |                          |                  |              |
| Napri Ltd             | <b>current</b>     | <b>80</b>                | <b>liability</b> |              |
| CBA Bank              | <b>non-current</b> | <b>1,000</b>             | <b>liability</b> |              |
| Total                 |                    | <b>1,080</b>             |                  |              |

## Analysing the Financial Statements:

### Problem T1.7

### Breaking down the different financial statements

(2015 S3 Lecture Week 1)

Message to Tutors: **[TOP PRIORITY TO COMPLETE]**

*Point out the difference between the Account & Narrative format. Inform students the Narrative format is:*

- The preferred exam format;
- Layout is  $A - L = E$  (Net Assets)

T-ACCOUNT FORMAT:  $A = L + E$

| DON'S AUTO REPAIRS               |          |                  |          |
|----------------------------------|----------|------------------|----------|
| Balance Sheet as at 30 June 2016 |          |                  |          |
| ASSETS                           |          | LIABILITIES      |          |
| Cash at bank                     | \$50 340 | Accounts payable | \$20 760 |
|                                  |          |                  | 201 000  |

**Student Workbook: Week 1**

|                     |          |                           |   |                  |
|---------------------|----------|---------------------------|---|------------------|
| Accounts receivable | 17 790   | Mortgage payable          | ? | <b>221 760</b>   |
| Repair supplies     | 14 610   |                           |   |                  |
| Repair equipment    | 110 700  |                           |   |                  |
| Land                | 60 000   | EQUITY                    |   |                  |
| Building            | 255 000  | <b>Don Brady, Capital</b> | ? | <b>286 680</b>   |
|                     | <b>?</b> |                           |   | <b>\$508 440</b> |
|                     |          |                           |   | <b>\$508 440</b> |

NARRATIVE FORMAT: **A – L = E**

| <b>DON'S AUTO<br/>REPAIRS<br/>Balance Sheet<br/>as at 30 June 2016</b> |          |                  |
|--|----------|------------------|
| <b>ASSETS</b>  |          |                  |
| Cash at bank   |          | \$50 340         |
| Accounts receivable  |          | 17 790           |
| Repair supplies  |          | 14 610           |
| Repair equipment   |          | 110 700          |
| Land   |          | 60 000           |
| Building   |          | 255 000          |
| <b>TOTAL ASSETS</b>  |          | <b>\$508 440</b> |
| <b>LIABILITIES</b>   |          |                  |
| Accounts payable   |          | \$20 760         |
| Mortgage payable   |          | 201 000          |
| <b>TOTAL LIABILITIES</b>   |          | <b>221 760</b>   |
| <b>NET ASSETS</b>  |          | <b>\$286 680</b> |
| <b>EQUITY</b>  |          |                  |
| <b>Don Brady, Capital</b>  |          | <b>\$286 680</b> |
|  | <b>?</b> |                  |
|  | <b>?</b> |                  |

***TUTOR REPPONSE: Reconcile Net Profit & Changes in Statement of Equity***

| <b>DON'S AUTO REPAIRS<br/>Income Statement for the year<br/>ended 30 June 2016</b> |           |
|--|-----------|
| <b>INCOME</b>  |           |
| Repair revenue   | \$442 500 |

|                                     |           |                    |
|-------------------------------------|-----------|--------------------|
| EXPENSES                            |           |                    |
| Advertising expenses                | \$ 20 250 |                    |
| Repair supplies expenses            | 91 710    |                    |
| Salaries and wages expense          | 127 800   |                    |
| Rent expense                        | 40 260    |                    |
| Telephone expense                   | 20 190    |                    |
| Light and power expense (Utilities) | 47 940    |                    |
|                                     |           | <b>? 348 150</b>   |
| PROFIT                              |           | <b>? \$ 94 350</b> |

**TUTOR REPONSE:** Link Equity of \$286 680 back to the Balance Sheet

| DON'S AUTO REPAIRS<br>Statement of Changes in Equity<br>For the year ended 30 June 2016 |                   |
|---|-------------------|
| Don Brady, Capital – 1 July 2015  | \$ 237 330        |
| <b><u>Retained Earning:</u></b>   |                   |
| Add: Profit for the year  | <b>? 94 350</b>   |
| Less: Drawings  | 45 000            |
| Don Brady, Capital – 30 June 2016   | <b>\$ 286 680</b> |

## Financial Statements: Putting it all together

### Problem T1.8

Murphy's Law Firm for the financial year ending 30 June 2016

(2015 S3 Lecture Week 1)

Message to Tutors:

**Optional depending on time. Revisit to complete if time permits.**

The following is a list of financial statement balances for Murphy's Law firm at 30 June 2016:

Required:

- A. For each of the items listed above (i) classify the item as an asset, liability, equity, revenue or expense: (ii) indicate whether the item should appear on the balance sheet, income statement or statement of change in equity.
- B. Prepare an Income Statement, Balance Sheet and a Statement of Changes in Equity for Murphy's Law Firm for the year ended 30 June 2016.

**Solution:**

| ✓<br>when | Account Name           | \$        | Asset, Liability,<br>Expense | Financial  |
|-----------|------------------------|-----------|------------------------------|--|
|           | Equity, Revenue,       | Statement | done                         |  |
|           | Accounts payable       | 1,405     | <b>Liability</b>             | <b>Balance Sheet</b>                                 |
|           | Accounts receivable    | 22,000    | <b>Asset</b>                 | <b>Balance Sheet</b>                                 |
|           | Advertising expense    | 20,600    | <b>Expense</b>               | <b>Income Statement</b>                              |
|           | Cash at bank           | 33,040    | <b>Asset</b>                 | <b>Balance Sheet</b>                                 |
|           | Electricity expense    | 720       | <b>Expense</b>               | <b>Income Statement</b>                              |
|           | Legal services revenue | 155,820   | <b>Revenue</b>               | <b>Income Statement</b>                              |
|           | Loan Payable           | 12,000    | <b>Liability</b>             | <b>Balance Sheet</b>                                 |
|           | Motor vehicle          | 36,695    | <b>Asset</b>                 | <b>Balance Sheet</b>                                 |
|           | Rent expense           | 32,000    | <b>Expense</b>               | <b>Income Statement</b>                              |
|           | Murphy, Capital        | ?         | <b>Equity</b>                | <b>Balance Sheet, Statement of Changes in Equity</b> |
|           | Murphy, Drawings       | 6,600     | <b>Equity</b>                | <b>Statement of Changes in Equity</b>                |
|           | Prepaid Insurance      | 2920      | <b>Asset</b>                 | <b>Balance Sheet</b>                                 |
|           | Unearned revenue       | 450       | <b>Liability</b>             | <b>Balance Sheet</b>                                 |
|           | Wages expense          | 52,050    | <b>Expense</b>               | <b>Income Statement</b>                              |
|           |                        |           |                              |  |



| Murphy's Law Firm<br>Income Statement<br>For the year ended 30 June 2016 |          |               |
|--|----------|---------------|
| <b>INCOME</b>  |          |               |
| Legal services revenue   |          | \$155 820     |
| <b>EXPENSES</b>  |          |               |
| Wages expense  | \$52 050 |               |
| Rent expense   | 32 000   |               |
| Advertising expense  | 20 600   |               |
| Electricity expense  | 720      | 105 370       |
| <b>PROFIT</b>  |          | <b>50 450</b> |

| Murphy's Law Firm<br>Balance Sheet<br>As at 30 June 2016 |  |               |
|--|--|---------------|
| <b>ASSETS</b>  |  |               |
| Cash at bank   |  | 33 040        |
| Accounts receivable                                      |  | 22 000        |
| Motor Vehicle  |  | 36 695        |
| Prepaid Insurance  |  | 2 920         |
|  |  | <b>94 655</b> |
| <b>LIABILITIES</b>                                       |  |               |
| Accounts payable   |  | 1 405         |
| Unearned Revenue   |  | 450           |
| Loan payable   |  | 12 000        |
|  |  | <b>13 855</b> |
| <b>NET ASSETS</b>  |  | <b>80 800</b> |
| <b>EQUITY</b>  |  |               |
| Murphy, Capital  |  | <b>80 800</b> |

| <b>Murphy's Law Firm</b><br><b>Statement of Changes In Equity</b><br><b>For the year ended 30 June 2016</b> |               |
|---|---------------|
| <b>Murphy, Capital – 1 July 2015 **</b>   | <b>36 950</b> |
| <b>Add:</b> Profit  | <b>50 450</b> |
|   | <b>87 400</b> |
| <b>Less:</b> Drawings   | <b>6 600</b>  |
| <b>Murphy, Capital – 30 June 2016</b>   | <b>80 800</b> |

**\*\*Beginning balance of capital is found by working backwards:**

$$\text{\$80 800} + \text{\$6 600} - \text{\$50 450} = \text{\$36 950}$$