Sydney Institute of Business and Technology

ACTG100 Accounting A

Student Workbook Answers

Lecture and Tutorial

Week 7:
Goods and Services Tax
Accounting Systems

Updated April 2016

The goods and services tax in Australia (GST)

Under the GST legislation, a business has to register for an Australian Business Number (ABN) and GST if their gross sales exceed $75 000 per year.

The GST is a tax levied (charged) at the rate of 10% on the supply (sale) of most services and goods. All supplies of services and goods are subject to GST unless they are 'non-taxable'. There are two types of **non-taxable supplies**:

- 'GST-free' supplies: these are services and goods exempted (not taxed) e.g. fresh food, educational courses, medical products and services, wages and salaries, capital contributions and withdrawals.
- 'input-taxed supplies: these include financial services such as bank fees and charges.

Accounting for GST

There will be **two** new accounts introduced to record GST transactions:

- **Collection of GST**

  This is GST that the business collects from its customers on sales or services. The business collects GST on behalf of the taxation authority and this amount is **owed** to the tax office. **GST Collection account** is classified as a *current liability*:

  Example 1: *received cash of $200 plus GST for services performed*

Date	DR Cash at Bank	220	
	CR Service Revenue		200
	CR GST Collection		20
	(Received cash for services)		

To help with understand only
(A↑)
(E↑)
(L↑)

  Example 2: *Invoiced customers for $2 000 plus GST for services performed*

Date	DR Accounts Receivable	2 200	
	CR Service Revenue		2 000
	CR GST Collection		200
	(Performed services on account)		

To help with understand only
(A↑)
(E↑)
(L↑)

- **GST Outlays**

This is GST paid to other businesses for the purchase of assets and expenses. The business will receive a refund (receive back) from the tax authority. **GST Outlays** (paid out) is classified as a *current asset*:

Example 3: *Purchased supplies costing $400 plus GST on credit*

Date	DR Supplies	400	
	DR GST Outlays	40	
	CR Accounts Payable		440
	(Purchased Supplies on credit)		

To help with understand only
(A↑)
(A↑)
(L↑)

Example 4: *Paid rent for the month, $6 000 plus GST*

Date	DR Rent Expense	6 000	
	DR GST Outlays	600	
	CR Cash at Bank		6 600
	(Paid Rent)		

To help with understand only
(E↓)
(A↑)
(L↑)

Summary:

GST is generally collected (only on taxable supplies) by a business from its customers and clients when goods or services are supplied The business also pays GST on goods and services it purchases from its suppliers for which it may claim a tax credit.

At the end of the tax period balances in the GST collections account and the GST outlays account are offset in order to show either a **net amount owing** to or a **net amount receivable** from the taxation authority

- The **difference** between the total GST the business collects on sales and the total it pays on purchases is *remitted* (sent) to the tax authority at regular time intervals;

If GST Collections > GST Outlays; the **net** amount is *remitted* to (sent to) the tax authority

Example:

GST Collections (Liability)	$10 000
Less: GST Outlays (Asset)	5 500
GST **remitted** to the tax authority	**4 500**

Remit
Business will *send* $4 500 to the Tax Office

- However, if the GST Outlays (asset) is greater/more than the GST Collections (liability), the tax authority *refunds* the amount to the business.

If GST Collections < GST Outlays; the **net** amount is reimbursed by (received from) the tax authority:

Example:

GST Collections (Liability)	$7 000
Less: GST Outlays (Asset)	8 500
GST **refund** received from tax authority	**1 500**

Refund
Tax Office will *return* $1500 to the business

Lecture Exercise 1.0:	**FYI NEWS: OPERATIONS IN MAY (with GST)**

[2015 S3, Lecture 3]

The following transactions occurred in FYI NEWS in May 2017:

Date	Related Activity	Business Transaction
May 1		Paid rent for the month, $6000 plus GST
May 4	[a]	Purchased office furniture on credit for $7000 plus GST
May 6		Received cash from customers of $500 plus GST for services performed
May 7		Purchased printing equipment costing $60000 plus GST. $5000 was paid in cash and the balance is to be paid within 30 days.
May 9		Paid wages expense of $5000
May 16	[a]	Paid for the office furniture purchased on May 4.
May 21	[b]	Invoiced customers $3000 plus GST for services performed
May 23		Paid $900 plus GST for a 1 year insurance policy
May 24		Paid internet expense of $330 including GST
May 28	[b]	Received cash of $3300 from customer account (The customers had been invoiced on May 21)
May 31		The owner withdrew cash of $1500 for personal expenses.

Required:

Use the transaction analysis (given below) to prepare journal entries for the above transactions.

Lecture Exercise 1.0: FYI NEWS – continued

Transaction Analysis: **Plus GST**
(Note: This has been provided to students in their workbook. Just talk through the analysis)

Date		(DEBIT INCREASES)	=	(CREDIT INCREASES)	(CREDIT INCREASES)
		ASSET	=	LIABILITY +	EQUITY
1 May		Cash - $6 600 **(A↓)** GST Outlays + $600 **(A↑)**	=		Rent Expense $ 6 000 **(E↓) reduces by $6000. Rent expense in the Income statement**
4 May	[a]	Office furniture +$7 000 **(A↑)** GST Outlays +$700 **(A↑)**	=	Accounts payable + $7 700 **(L↑)**	
6 May		Cash + $ 550 **(A↑)**	=	GST Collections +50 **(L↑)**	Services revenue $500 **(E↑) improves $500. Services revenue in the Income Statement**
7 May		Printing Equipment $60 000 **(A↑)** GST Outlay $6 000 **(A↑)** Cash – $5 000 **(A↓)**	=	Accounts payable + 61 000 **(L↑)**	
9 May		Cash – $5 000**(A↓)**	=		Wages Expense $5 000 **(E↓) reduces by $5000 Wages expense in the Income statement)**
16 May	[a]	Cash – $7 700 **(A↓)**	=	Accounts payable - $7 700 **(L↓)**	
21 May	[b]	Accounts receivable + $3 300 **(A↑)**	=	GST Collections + $300 **(L↑)**	Services revenue $3 000 **(E↑) improves. Services revenue in the Income Statement**
23 May		Cash - $990 **(A↓)** Prepaid Insurance + 900 **(A↑)** GST Outlays +90 **(A↑)**	=		
24 May		Cash - 330 **(A↓)** GST Outlays +30 **(A↑)**	=		Internet Expense $ 300 **(E↓) reduces. Internet expense in the Income statement)**
28 May	[b]	Cash + $3 300 **(A↑)** Accounts receivable - $3 300 **(A↓)**			
31 May		Cash –$ 1 500 **(A↓)**	=		Drawings $1 500 **(E↓)**

Lecture Exercise 1.0: **FYI NEWS**

General Journal: **(Answers)**

Date	Account/ Details	Debit	Credit
1 May	**Rent expense**	**$6 000**	
	GST Outlays	**600**	
	Cash at bank		**$6 600**
	(Paid rent)		
4 May	**Office furniture**	**7 000**	
	GST Outlays	**700**	
	Accounts payable		**7 700**
	(Purchased office furniture on credit)		
6 May	**Cash at bank**	**550**	
	Service revenue		**500**
	GST Collections		**50**
	(Cash received for services)		
7 May	**Printing Equipment**	**60 000**	
	GST Outlays	**6 000**	
	Cash at bank		**5 000**
	Accounts payable		**61 000**
	(Purchased printing equipment)		
9 May	**Wages Expense**	**5 000**	
	Cash at Bank		**5000**
	(Paid Wages Expense)		
16 May	**Accounts payable**	**7 700**	
	Cash at bank		**7 700**
	(paid accounts payable)		

No GST here. Wages is GST exempt. Read the notes at the beginning on 'GST-free' Supplies.

No GST here. FYI is paying off the accounts payable amount from 4th May. The GST on purchase was recorded in 4th May. Do not count GST twice.

Lecture Exercise 1.0: FYI NEWS (continued)

General Journal: **(Answer)**

Date	Account/ Details	Debit	Credit
21 May	Accounts receivable	$3 300	
	Service revenue		$3 000
	GST Collections		300
	(Invoiced customer for services)		
23 May	Prepaid Insurance	900	
	GST Outlays	90	
	Cash at bank		990
	(paid 1 year insurance)		
24 May	Internet Expense	300	
	GST Outlays	30	
	Cash at bank		330
	(Paid Internet)		
28 May	Cash at bank	3 300	
	Accounts receivable		3 300
	(Received cash on account)		
31 May	Drawings	1 500	
	Cash at bank		1 500
	(Owner withdrew cash)		

No GST here. FYI received payment from the customer based on services performed on 21st May. The GST on services was recorded in 21st May. Do not count GST twice.

No GST here. Drawings is GST exempt. Read the notes at the beginning on 'input-tax' Supplies.

GST for Inventory

(refer back to these notes for GST transactions in Lectures 8, 9 & 10)

Purchasing Inventory

Assume Rachel Retailer (who uses a perpetual inventory system) purchases 10 tables on credit from a manufacturer for $440 each (including $40 GST per item) or $400 plus GST.

		Debit	Credit
Date	**Inventory (10 x $400)**	**4 000**	
	GST Outlays* (as asset account)	**400**	
	Accounts payable		**4 400**
	(Purchase of furniture from the manufacturer)		

* GST can be calculated from $4 400 ÷ 11 = $400

Important to note:

The $400 debit to the GST Outlays account represents an asset, a future economic benefit for the business. This amount can be offset against any future GST liability owing (GST collection) to the tax authority.

Inventory is recorded net of GST, as the $400 is not part of the cost to the business of acquiring the inventory.

The full amount is payable to the manufacturer, including GST, as the manufacturer acts as a collecting agent for the tax authority.

Purchases returns

Rachel Retailer ordered the wrong quantity and returns 3 tables, receiving an adjustment credit note from the manufacturer. The Tables originally costs $440 each (including $40 GST per item).

		Debit	Credit
Date	**Accounts Payable**	**1 320**	
	Inventory (3 x $400)		**1 200**
	GST Outlays* (an asset account)		**120**
	(Return of furniture to the manufacturer)		

* GST can be calculated from $1 320 ÷ 11 = $120

Important to note:

The effect of the purchase return is the reverse of the purchase. The inventory and GST Outlays accounts are reduced and the amount owing to the supplier is now only $3 080 ($4 400 - $1 320). The balance of the GST Outlays account is now $280 debit. Inventory balance is $2 800 (7 tables x $400).

Selling Inventory

Rachel Retailer sells 5 tables on credit to a customer, who is buying the goods for family members. Each table sells for $550 including $50 GST (or $500 plus GST).

		Debit	Credit
Date	**Accounts Receivable**	**2 750**	
	GST Collections* (liability account)		**250**
	Sales (5 x $500)		**2 500**
	(Sale of furniture to a customer)		
	Cost of Goods Sold	**2 000**	
	Inventory (5 x $400)		**2 000**
	(The cost of inventories sold)		

* GST can be calculated from $2750 ÷ 11 = $250

Important to note:

The $250 GST collected represents an amount owing to the tax authority based on GST collected. The Sales account is credited for $2 500 net of the GST: the $250 is note sales revenue rather it is collected on behalf of the tax authority.

A debit of $2 750 (5 x $500) is made to Accounts Receivable to record the amount due from the customer. When goods are sold an entry is made to record the cost of goods sold (COGS). This does not involve GST as the Inventory was recorded as net of GST.

Sales returns and allowances

The following week, the customer returns one of the tables as they realised that they only needed 4 tables. Rachel Retailer issues an adjustment note and credits their account.

		Debit	Credit
Date	**Sales Returns**	**500**	
	GST Collections* (a liability account)	**50**	
	Accounts Receivable		**550**
	(Sales return of furniture from a customer)		
	Inventory	**400**	
	Cost of Goods Sold		**400**
	(Cost of Goods Sold adjustment for goods returned)		

*** GST can be calculated from $550 ÷ 11 = $50**

Important to note:

The $50 debit to GST Collections represents an amount that is no longer owed to the tax authority. The Sales account is debited only for $500 as the original sales transaction was net of GST. A credit of $550 is made to Accounts Receivable to recognise the amount no longer due from the customer. As the goods were returned into inventory, Inventory is increased and Cost of Good Sold decreased, again net of any GST as the asset Inventory is recorded net of GST paid.

Settlement discount (GST is ignored for this course)

GST should also be recorded for discounts but you are not required to do GST adjustment for discounts in this course.

~~~End of Goods & Services Tax ~~~
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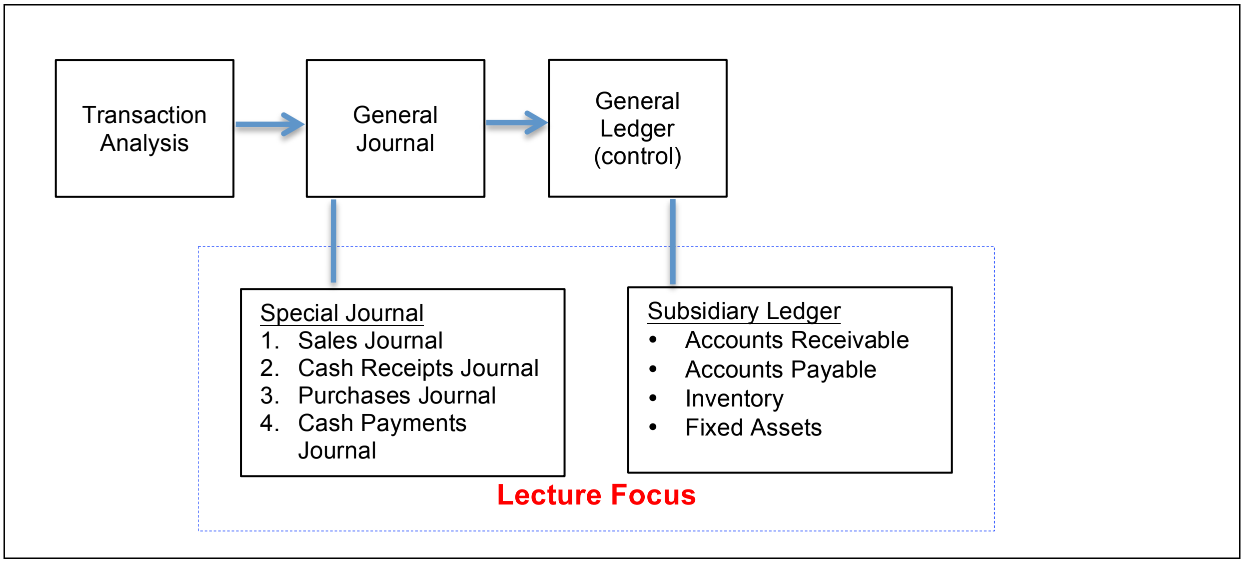
ACCOUNTING SYSTEMS



SPECIAL JOURNALS

A special journal is an accounting journal designed to record similar types of transactions. The journal is to record transactions that happen often (frequently) and can be grouped together in a dedicated special accounting journal to help a business reduce the time needed to post from journal to the ledger accounts. Special journals are most useful in retail (merchandising) businesses and commonly fall into four categories of frequent and similar transactions:

The **special journals** used to record frequent and same type (alike) of transactions:

	Transactions	Special Journal	Posting abbreviation
1	Sale on credit	Sales journal	SJ
2	Cash receipt	Cash receipts journal	CRJ
3	Purchase on credit	Purchases journal	PJ
4	Cash payment	Cash payments journal	CPJ
5	All others (not in 1,2,3,4)	General journal	GJ

The **general journal** is usually used for:

- All other transactions not recorded in the special journals;
- Adjusting entries (balance date);
- Closing entries (end-of-financial year)

1. **Sales Journal (SJ)** only for sale of business **inventory** on **credit**:

Most retailers sell at least some of their inventory on credit (sell now collect later: accounts receivable). Rather than record sales on credit that happen often (frequently) in the general journal, these credit sales that result in a *debit* to Accounts Receivable, and *credit* to Sales can be recorded in the special journal for selling the business inventory on credit: the Sales Journal.

2. **Cash Receipts Journal (CRJ)** for **all** cash received (including cash sales):

The CRJ is used to record all transactions involving receipt of all types of cash (a debit to Cash at Bank). The typical sources of cash are the sale of goods for cash, the collection of accounts receivable, capital invested by owners, borrowings, rental income and investment income (cash received from business investments that produce income)

3. **Purchases Journal (PJ)** only for credit purchases from accounts payable suppliers:

Each entry in this journal results in a *debit* to Inventory or purchases (depending on whether a perpetual or periodic inventory system is used) and a *credit* to Accounts Payable. The purchases journal is to record items that are purchased with the intention to be resold for income (ie. Sales).

They are not the same as the purchase of equipment or supplies that **must** be recorded in the general journal and **not** the purchases journal. Equipment and supplies are not part of inventory or purchases to be resold (i.e. Sales) but are bought to be used in the business to help produce income.

4. **Cash Payments Journal (CPJ)** records **all** payments of cash regardless of whether they relate to inventory, equipment or supplies.

All payments are recoded by the cash payments journal. Businesses make most of their payments by cheque. Since the CPJ is for all types of payments it can involve payment of accounts payable, cash payment for supplies, prepaid expenses (e.g. prepaid insurance), payment for inventory or drawings made by the business owner.

SUBSIDIARY LEDGER

Subsidiary ledger is used (introduced) whenever there is a need for **more detailed** information on a group of similar (same type) transactions that the general ledger account cannot provide. Subsidiary ledgers are useful in situations where a business needs to keep details on particular groups of customers or suppliers and what transactions **each** individual balances have. Two common subsidiary ledgers are:

1. The **accounts receivable** (or customer's) subsidiary ledger; which collects transaction data of individual (each) customer who bought *on account*;

In each of these subsidiary ledgers, individual accounts allow management to monitor (look into) the details of individual customer's receivable balance(s) to help understand their customers buying needs or their payment habits and to minimise bad debts (ie.an accounts receivable customer who is not able to pay their account).

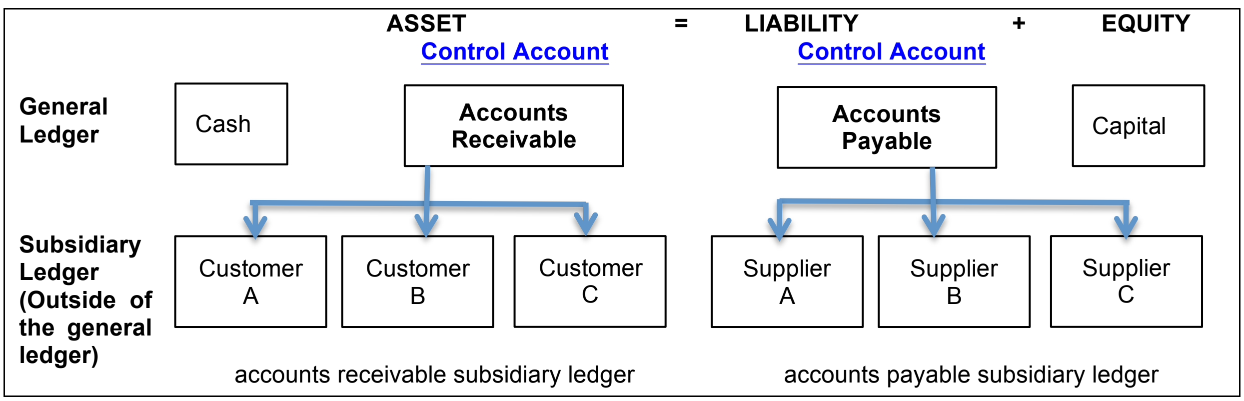
Special information helpful in the subsidiary account for each customer: credits sales, cash received on account, sales returns from accounts receivable customers.

2. The **accounts payable** (or suppliers') subsidiary ledger; which collects transaction data of individual creditors.

   Each creditor (supplier) has a dedicated account to record purchases affecting each creditor (supplier). This will allow management to have up-to-date information on each specific account balance. It allows management to plan (budget) how much to spend during each accounting period or each accounting fiscal year.

   Special information helpful in the subsidiary account for each supplier: credits purchases, payments to accounts payable suppliers, purchase returns to suppliers.

Example of how the subsidiary ledger fits into the control account (in the general ledger):



Important: Subsidiary ledgers sit *outside* the general ledger and are not used when preparing the trial balance. To prepare the trial balance we use only the general ledger account. The general ledger account will have a **control account** that *summarises* subsidiary ledgers (i.e. all subsidiary ledgers of accounts receivable and payable will have their own control account):

The general ledger control account is therefore a summary of information from the subsidiary ledger. This means that:

- Total of the balances of the individual subsidiary ledger must equal the balance in the control account of its general ledger.

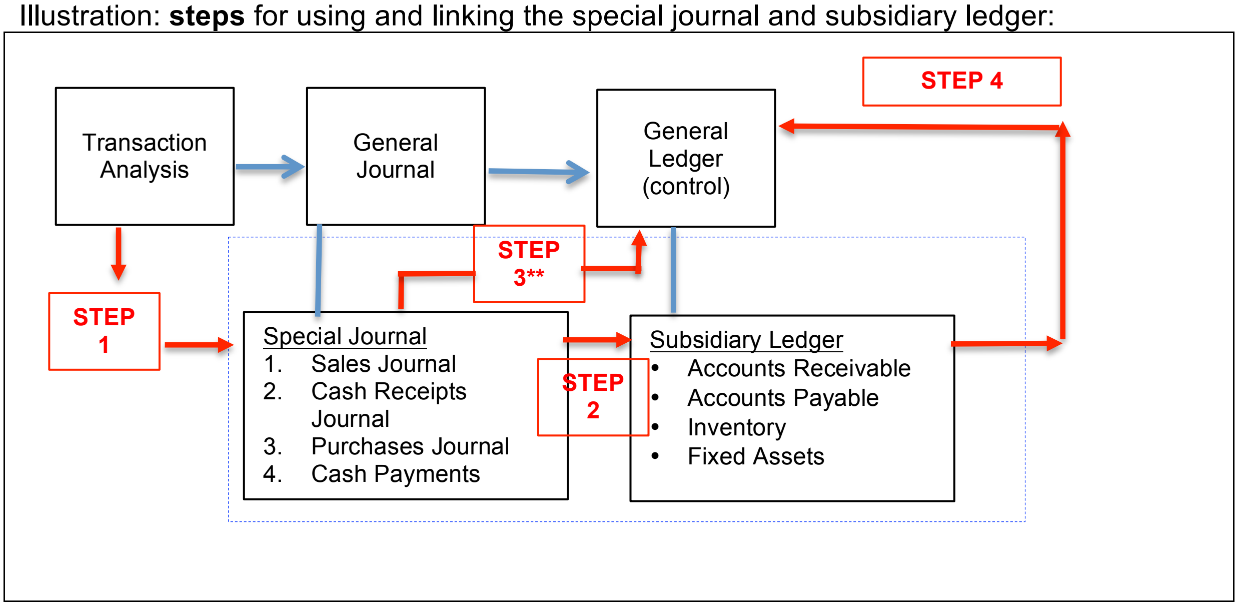
NOTE: subsidiary ledgers for inventory and fixed assets will not be covered in this Course.

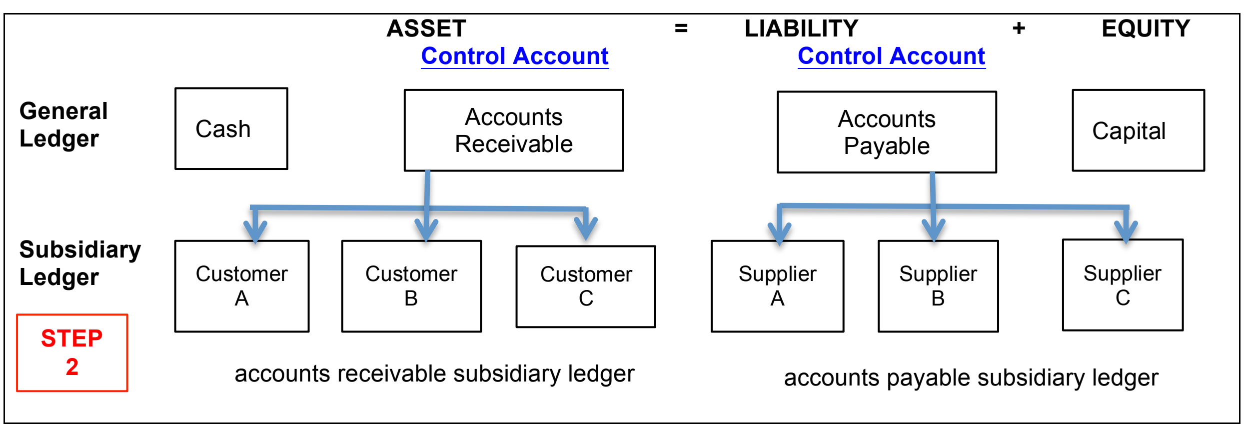
HOW THE SPECIAL JOURNAL AND SUBSIDIARY LEDGER WORK:

Steps for using the Special Journals and Subsidiary Ledgers:

1. Record the transaction in the suitable (appropriate) special journal:
2. Update the related subsidiary ledger:
    - *Accounts Receivable* from the sales journal or cash receipts journal; or
    - Accounts Payable from the purchases journal or cash purchases journal
3. **Add up special journals and post the totals to the General Ledger at the end of the accounting period;
4. Prepare a listing of the individual accounts from the subsidiary ledgers and ensure that the total equals the balance in the relevant General Ledger account.

Illustration: **steps** for using and linking the special journal and subsidiary ledger:





Transactions that use Special Journals and Subsidiary ledgers:

Transaction Type	Journal	Subsidiary Ledger
Credit Sales (to customers)	**Sales Journal (SJ)**	**Accounts Receivable**
Cash Sales (to customers)	**Cash Receipts Journal (CRJ)**	**none**
Receipt of cash from an Accounts Receivable customer	**Cash Receipts Journal (CRJ)**	**Accounts Receivable**
Credit Purchases (from suppliers)	**Purchases journal (PJ)**	**Accounts Payable**
Cash Purchases (from suppliers)	**Cash Payments Journal (CPJ)**	**none**
Payment of cash to Accounts Payable Supplier	**Cash Payments Journal (CPJ)**	**Accounts Payable**
Cash payment of expense	**Cash Payments Journal (CPJ)**	**none**

Lecture Exercise 1.2: Secret Garden

Secret Garden commenced operations on 1 March. The business uses a Sales Journal (SJ), Purchases Journal (PJ), Cash Receipts Journal (CRJ) and Cash Payments Journal (CPJ). Accounts Receivable (ARSL) and Accounts Payable Subsidiary Ledgers are also maintained (APSL)

Transactions for the month of March are as follows (Ignore GST):

Date	Transaction	Journal	Subsidiary Ledger
Mar 1	Owner contributed cash of $50 000	**CRJ**	**none**
Mar 2	Purchased inventory *on credit* from Rosie's Roses, $8 000	**PJ**	**APSL**
Mar 3	Sold inventory *on account* to Fareeza's Flower's, $2 000	**SJ**	**ARSL**
Mar 10	Cash sales to customers $880	**CRJ**	**none**
Mar 12	Paid Rosie's Roses for the purchase on Mar 2	**CPJ**	**APSL**

Date	Transaction	Journal	Subsidiary Ledger
Mar 15	Purchased inventory *on credit* from Asha's Orchids $3 200.	**PJ**	**APSL**
Mar 16	Paid Wages $6 000	**CPJ**	**none**
Mar 18	Sold inventory *on account* to Sam's Gardens $4 800	**SJ**	**ARSL**
Mar 20	Receive cash *on account* of $2 000 from Fareeza's Flowers (see Mar 3)	**CRJ**	**ARSL**
Mar 22	Cash purchases of $440 were made	**CPJ**	**none**
Mar 24	Sold inventory *on credit* to Treelovers $6 000	**SJ**	**ARSL**
Mar 25	Purchased inventory *on credit* from Nandini's Magnolias $1 800.	**PJ**	**APSL**
Mar 27	Received cash *on account* from Sam's Gardens of $4 800 (see Mar 18)	**CRJ**	**ARSL**
Mar 30	Sold inventory *on account* to Anne's Plant Kingdom $1 200	**SJ**	**ARSL**

Required:

A. Complete the table above by:

1. Indicating the Special Journal for which the transaction is to be recorded; and
2. Identifying the Subsidiary Ledger to be updated

B. Record the above transactions in the Special Journals and update the relevant subsidiary ledgers where appropriate:

Special Journals:

Purchases Journal (PJ)

Date	Account	Post Ref.	Purchases
2/3	**Rosie's Roses**	✔	**$8 000**
15/3	**Asha's Orchids**	✔	**3 200**
25/3	**Nandini's Magnolias**	✔	**1 800**
			$13 000

Sales Journal (SJ)

Date	Account	Post Ref.	Sales
3/3	Fareeza's Flowers	✔	$2 000
18/3	Sam's Gardens	✔	4 800
24/3	Treelovers	✔	6 000
30/3	Anne's Plant Kingdom	✔	1 200
			$14 000

Cash Receipts Journal (CRJ)

Date	Account	Post Ref.	Cash at Bank	Cash Sales	Accounts Receivable	Other
1/3	Capital		50 000			50 000
10/3	Cash Sales		880	880		
20/3	Fareeza's Flowers	✔	2 000		2 000	
27/3	Sam's Gardens	✔	4 800		4 800	
			57 680	880	6 800	50 000

Cash Payments Journal (CPJ)

Date	Account	Post Ref.	Cash Purchases	Accounts Payable	Other	Cash at Bank
12/3	Rosie's Roses	✔		8 000		8 000
16/3	Wages Expense				6 000	6 000
22/3	Cash Purchases		440			440
			440	8 000	6 000	14 440

Subsidiary Ledgers:

Accounts Receivable Subsidiary Ledger:

Fareeza's Flowers

Date	Post Ref.	Debit	Credit	Balance
3/3	SJ	2 000		2 000 (DR)
20/3	CRJ		2 000	-

Sam's Gardens

Date	Post Ref.	Debit	Credit	Balance
18/ 3	SJ	4 800		4 800 (DR)
27 /3	CRJ		4 800	-

Anne's Plant Kingdom

Date	Post Ref.	Debit	Credit	Balance
30/ 3	SJ	1 200		1 200 (DR)

Treelovers

Date	Post Ref.	Debit	Credit	Balance
24/3	SJ	6 000		6 000 (DR)

Accounts Payable Subsidiary Ledger:

Asha's Orchids

Date	Post Ref.	Debit	Credit	Balance
15/3	PJ		3 200	3 200 (CR)

Nandini's Magnolias

Date	Post Ref.	Debit	Credit	Balance
25/3	PJ		1 800	1 800 (CR)

Rosie's Roses

Date	Post Ref.	Debit	Credit	Balance
2/3	PJ		8 000	8 000 (CR)
12/3	CPJ	8 000		-

~~~End of Lecture~~~
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Tutorial

Week 7

Lecture 7 revision - Goods and Services Tax

Kwan Electronics is a retailer of electronic project kits. Jack Kwan supplies to many local schools. Each electronic kit sells for $550 (including $50 GST) or $500 plus GST. The electronic kits are purchased from a manufacturer for $330 each (including $30 GST per item) or $300 plus GST.

Jack has completed an introductory accounting course and has prepared the following information required for the GST calculations:

Event		
[1]	Total sales (including GST) on account.	$55 000
[2]	Total sales returns (including GST)	1 100
[3]	Total purchases (including GST) on account	19 800
[4]	Total purchase returns (including GST)	2 640

Jack is unable to prepare the journal entries for GST transactions and has turned to you to assist him:

Required:

Journalise the sales and purchases transactions, as well as the payment of GST to the tax authority, using GST Outlays and GST Collections accounts.

Selling Inventory:

	Calculation:	
Sales:	**Number of units sold = $55 000 ÷ 550 each**	**100 units**
COGS:	**COGS = 100 units x $300 each**	**$30 000**

Event	Details	Debit	Credit
[1]	**Accounts Receivable**	**55 000**	
	GST Collections ($55 000 ÷ 11)		**5 000**

	Sales ($55 000 – GST)		50 000
	(Sale of project kits to a customer on account)		
[1]	Cost of goods sold	30 000	
	Inventory		30 000
	(The cost of inventories sold)		

Sales returns and allowances

	Calculation:	
Sales Return	Number of units returned = $1 100 ÷ 550 each	2 units
COGS:	COGS = 2 units x $300 each	$600

Event	Details	Debit	Credit
[2]	Sales Return	1 000	
	GST Collections ($1 100 ÷ 11)	100	
	Accounts Receivable		1 100
	(Sales return from a customer)		
[2]	Inventory	600	
	Cost of Goods Sold		600
	(Cost of Goods Sold adjustment for goods returned)		

Purchasing Inventory

	Calculation:	
Purchase:	**Number of units bought = $19 800 ÷ 330 each**	**60 units**

Event	Details	Debit	Credit
[3]	**Inventory**	**18 000**	
	GST Outlays ($19 800 ÷ 11)	**1 800**	
	Accounts Payable		**19 800**
	(Purchase of kits from the manufacturer)		

Purchases return

	Calculation:	
Purchase Return:	**Number of units returned = $2 640 ÷ 330 each**	**8 units**

Event	Details	Debit	Credit
[4]	**Accounts Payable**	**2 640**	
	GST Outlays ($2 640 ÷ 11)		**240**
	Inventory		**2 400**
	(Return of kits to the manufacturer)		

Exercise 5.3 Part C **Closing entries**

(source: HEM, 9E Chapter 5 p214-215)

The following worksheet (below after the General Journal Form) with the adjusted trial balance was taken from the accounting books of Miranda's Management Services on 30 June 2016.

Required:

C. Record the closing entries in the general journal.

C. Answer:

Closing entries on 30 June 2016

Date	Details	Debit	Credit
Jun 30	Service Revenue	$340	
	Profit or Loss Summary		$340
	(Close income accounts)		
Jun 30	Profit or Loss Summary	304	
	Wages Expense		148
	Electricity Expense		54
	Sundry Expense		26
	Insurance Expense		16
	Depreciation Expense – Equipment		60
	(Close expense accounts)		
Jun 30	Profit or Loss Summary	36	
	Miranda Pike, Capital		36
	(Transfer loss to capital account)		
Jun 30	Miranda Pike, Capital	50	
	Miranda Pike, Drawings		50
	(Transfer drawings to capital)		

MIRANDA'S MANAGEMENT SERVICES

Worksheet

for the year ended 30 June 2016

($'000)

	Unadjusted trial balance		Adjustments		Adjusted trial balance		Income statement		Balance sheet	
Account title	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit	Debit	Credit
Cash at Bank	80				80				80	
Accounts Receivable	74				74				74	
Prepaid Insurance	24			(2) 16	8				8	
Equipment	230				230				230	
Accum. Depr. Equipment		60		(3) 60		120				120
Accounts Payable		64				64				64
Miranda Pike, Capital		204				204				204
Miranda Pike, Drawings	50				50				50	
Service Revenue		340				340		340		
Wages Expense	130		(1) 18		148		148			
Electricity Expense	54				54		54			
Sundry Expense	26				26		26			
	668	668								
Wages Payable				(1) 18		18				18
Insurance Expense			(2) 16		16		16			
Depr. Expense – Equipment			(3) 60		60		60			
			94	94	746	746	304	340	442	406
Profit for the period							36			36
							340	340	442	442

Exercise 5.4 Part B	**Closing entries**

(source: HEM, 9E Chapter 5 p215)

The Worksheet provides adjusted trial balance for Elliot Painting Services:

ELLIOT PAINTING SERVICES
Worksheet (Partial)
for the year ended 30 June 2016

	Adjusted trial balance		Income statement		Balance sheet	
Account	Debit	Credit	Debit	Credit	Debit	Credit
Cash at Bank	$1 230				$1 230	
Accounts Receivable	75 600				75 600	
Prepaid Rent	1 800				1 800	
Office Supplies	8 320				8 320	
Equipment	160 000				160 000	
Accum. Depr. Equip't		$25 000				$25 000
Accounts Payable		54 000				54 000
Salaries Payable		8 760				8 760
Unearned Revenue		3 430				3 430
F. Elliot, Capital		101 500				101 500
F. Elliot, Drawings	22 000				22 000	
Painting Revenue		219 650		219 650		
Salaries Expense	106 000		106 000			
Rent Expense	6 050		6 050			
Depreciation Expense	8 040		8 040			
Telephone Expense	4 020		4 020			
Office Supplies Used	10 080		10 080			
Sundry Expenses	9 200		9 200			
	$412 340	$412 340	143 390	219 650	268 950	192 690
Profit for the period			76 260			76 260
			$219 650	$219 650	$268 950	$268 950

Required:

Prepare the closing entries necessary at 30 June 2016, assuming this date is the end of the entity's accounting period.

C. Answer:

Closing entries on 30 June 2016

Date	Details	Debit	Credit
Jun 30	Painting Revenue	$219 650	
	Profit or Loss Summary		$219 650
	(Close income accounts)		
Jun 30	Profit or Loss Summary	143 390	
	Salary Expense		106 000
	Rent Expense		6 050
	Depreciation Expense		8 040
	Telephone Expense		4 020
	Office Supplies Expense		10 080
	Sundry Expenses		9 200
	(Close expense accounts)		
Jun 30	Profit or Loss Summary	76 260	
	F Elliot, Capital		76 260
	(Transfer profit to capital account)		
Jun 30	F Elliot, Capital	22 000	
	F Elliot, Drawings		22 000
	(Transfer drawings to capital)		

DISCUSSION QUESTION SOLUTIONS

Question 1	Cynthia's beauty services business

Chapter 5 Hoggett (p 53)

The following are financial statements for Cynthia's Beauty Services

Cynthia's Beauty Services **Balance Sheet** **As at 31 January 2016**	
Current Assets	
Cash at Bank	**$17 750**
Nail Supplies	**1 700**
	19 450
Non-Current Assets	
Massage and manicure tables	**6 000**
Van	**32 000**
	38 000
TOTAL ASSETS	**57 450**
TOTAL LIABILITIES	**NIL**
NET ASSETS	**57 450**
EQUITY	
Cynthia Jones, Capital	**57 450**

Cynthia's Beauty Services **Income Statement** **For the month ended 31 January 2016**		
Income		
Beauty services		**$6 050**
Expenses		
Nail supplies expense	**800**	
Wages expense	**600**	**1 400**
Profit		**4 650**

Cynthia's Beauty Services **Statement of Changes in Equity** **For the year ended 31 January 2016**

Cynthia Jones, Capital – 2 January 2016		**$53 000**
Add:	Profit for the month	**4 650**
		57 650
Less:	Drawings	**200**
Cynthia Jones, Capital – 31 January 2016		**57 450**

Required:

1. *Explain the basic differences between a sole trader (or single proprietorship), a partnership and a company.*
2. *Discuss the factors that need to be considered in selecting an appropriate structure for Cynthia's beauty services business* ***(for discussion with students: see below)***

THIS SECTION IS PART OF THE STUDENTS WORKBOOK: for DISCUSSION ONLY.

Answer: Part 1

The three basic business structures are:

Sole Trader

Sole traders are where individuals conduct business in their own capacity.
• They would be contributing their own capital or equity to the business and would be borrowing money in the name of the business in their own name.
• They would be liable to repay the outstanding debt of the business and, if unable to repay, the bank, would have access to their own personal assets to repay the outstanding debt.
• This business structure is suitable for small operations with small staff and turnover.
• The sole trader has sole responsibility and control for the business operations and activities. This structure is suitable for small businesses that require minimal capital to set up and have relatively low running costs and risk.

Partnership

A **partnership** is two or more persons in business together, operating under a partnership agreement that may or may not be a formally written document.

- Partnerships have the advantage over sole traders in that they have a larger base for capital contribution and are able to share the risks and responsibilities associated with running a business.
- The partnership is treated as a separate entity for accounting purposes but is not a separate legal entity. This means that the underlying assets and liabilities of a partnership belong to the individual partners in the proportion agreed upon as part of the partnership agreement. Therefore if the business activities prove to be unsuccessful, creditors have the right to access the personal assets of the individual partners in the event the business is unable to repay any outstanding debt.
- For this reason, the partnership structure is usually used where there is a low element of risk to the business or where the law dictates that the business entity must be run by the individuals providing the service. For example, work completed by professionals including accountants and lawyers.

Company

The **company** is a separate legal entity with ownership of a company attributed to shares held.

- The owners of the company are known as shareholders. The advantage of this business structure is that, as a separate legal entity, the assets and liabilities belong to the company. In the event the business is unable to repay its debt, the creditors only have access to company assets for repayment of the debt. The investment in the company by its shareholders is limited only to the shareholders' capital contribution, i.e. what the shareholder pays for the shares.
- This business structure is more appropriate for entities requiring larger capital contribution, which have a large number of overheads and employees and has a higher business risk.
- The disadvantages include higher set up and ongoing costs and possible reduction in control over the business operations where shareholders are not directly involved in the business operations.

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Factors that Cynthia needs to consider in selecting an appropriate structure for her business include:

- Simplicity in setting up the business

  Sole traders and small partnerships are easier to set up compared to companies.

- Establishment costs

  Companies are more expensive to establish compared to sole traders and partnerships.

- Liability issues

  Sole traders and partnerships have unlimited liability, which means owners and partners are personally liable for their business' debts, including those resulting from lawsuits or the actions of other partners. If unlimited liability is a concern, then Cynthia may want to consider setting up a company instead of being a sole trader or partnership.

- Tax

  Reporting requirements for companies are far greater than for sole traders and partnerships.

- Control of the business

  As an owner of a sole trader, Cynthia would have a complete control over her business. If she chooses to partner with someone through a partnership, she will need to discuss business matters with her partner. If Cynthia decides to set up a company and employs a management team, she may not have as much control in running her business, as it will be the responsibility of the management team.

- Access to capital

  The access to finance for a sole trader is limited to the owner's resources. On the other hand, a partnership has greater access to capital from resources of all partners, and a company has even far greater access to capital from various shareholders.

Ethics and governance

The impact of a bonus incentive scheme on the financial statements

(source: HEM, 9E Chapter 4 p181)

Lucia works as an accountant for a motor vehicle engine parts manufacturer called Vroom Ltd, owned by an international car firm. Her manager, Freda Chuse, is paid a bonus depending on the profitability of the company. If Vroom Ltd makes $1 million profit, Freda receives a bonus of $20 000 that increases progressively to $30 000 for a $3 million profit. If the profit of Vroom Ltd exceeds $3 million, Freda receives the maximum bonus of $30 000. Vroom Ltd currently receives a grant from the government of $100 000 per year to employ and train apprentice mechanics.

At the end of May, it appears that Vroom Ltd will make a profit of approximately $3.5 million for the year ending 30 June 2016. Freda approached Lucia and said that if the company made too much profit then the government may stop paying Vroom Ltd the grant for training apprentice mechanics, and it would lose the $100 000 tax-free cash inflow. Freda instructed Lucia to find ways of deferring recognition of as much revenue as possible until the following financial year, for which the forecasts for the industry were quite poor, and to accrue as many expenses as possible at the end of the current accounting period when it came to making the end-of-period adjustments. Although Lucia was not happy with this instruction, she did not want to risk her own opportunities for promotion by upsetting her manager.

Required

A. Who are the stakeholders in this situation?
B. Why do you believe Freda asked Lucia to do this?
C. What are the ethical issues involved?
D. Can Lucia defer revenues and accrue as many expenses as possible and still be ethical?

THIS SECTION IS PART OF THE STUDENTS WORKBOOK: for DISCUSSION ONLY.

Answers

A. The stakeholders are:

- The manager, Freda Chuse
- The accountant, Lucia
- The present and potential shareholders of the entity.

B. Freda may well be asking Lucia to reduce the reported profit in an attempt to avoid losing the government grant for employing and training apprentice mechanics. It may also be that as Freda's bonus is maximised when the firm earns $3m. There is no benefit to her in making $3.5m profit. However, if Freda believes that the following accounting period is not likely to make as much profit it is in her best interests to defer(delay) the recognition in excess of $3m until the following accounting period to maximise her bonus in that period while having no negative impact on her current period's bonus.

C. It is acceptable for Lucia to ensure that all assets, liabilities, income and expenses are recorded in the correct accounting period. It becomes unacceptable, and unethical, if Lucia recognises other assets, liabilities that do not legitimately reflect the entity's performance and financial position in the current period. Nevertheless, there are several techniques that Lucia could use to manipulate (or 'massage') the profit figure e.g. changing the method of calculating depreciation, or changing useful lives of assets. These changes in techniques may be generally acceptable, and quite legal; but are they ethical? It becomes unethical if the manager places so much pressure on Lucia to carry out adjustments that she believes should not be made, on the grounds that the results for the period would become distorted.

D. Lucia can accrue all possible incomes and defer all possible expenses through adjusting entries, but should not be involved in going so far as to distort the financial performance and financial position of the entity so as to mislead present and potential shareholders.