

Summary Exercise 2

Yeah, here I am back again! I've figured out how to record my transactions into the cashbook and general journal but I still can't get the hang of doing the reports. So here are extracts of my accounting records for **Funky Franky**, and I would appreciate it if you could prepare the relevant accounting reports. Also, could you please answer the queries that I have listed?



Funky Franky: Balance Sheet as at 30/4/2007			
<u>ASSETS</u>	\$	<u>LIABILITIES</u>	\$
Vehicle	11000	Overdraft	330
Turntable	2000	Loan: NAB	5000
Speakers	1500	Loan: Mrs Rap	3000
CD unit	900	GST payable to ATO	420
Stock of streamers & prizes	250		
Amplifier	6000		
Stock of CD's	6000		
Lights	650		
Trailer	500	<u>OWNERS EQUITY</u>	
Microphone	250	Capital, Franky	20300
Total Assets	29050	Total Equities	29050

Funky Franky: Cash Journals

Cash Receipts				Values in these columns exclude GST			GST rec'd from customers
Date	Details	Rec No		Bank	Fees	Capital	
MAY	TOTALS		3300	3000			300

Cash Payments			Bank	Values in these columns exclude GST								GST paid to suppliers
Date	Details	Chq No		Draw.	Post.	Advert.	Streamers & Prize	CD's	Station	Vehicle fuel	Loan Mrs Rap	
MAY	TOTALS		3017	900	30	400	500	180	60	300	500	147

Funky Franky: General Journal

DATE	PARTICULARS	AMOUNT
MAY	Drawings of CD's for own use (No GST)	100
MAY	Franky contributed personal party lights to the business (No GST)	500
31/5	Stocktake of streamers and prizes (No GST)	90

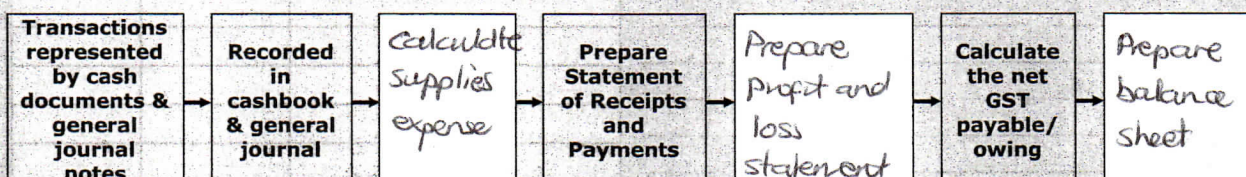
Explain the purpose of the general journal.

Used to record transactions that do not involve cash transfer

Explain the difference between the cash payment for streamers & prizes and the expense for streamers & prizes.

The cash payments for streamers and prizes represents streamers and prizes purchased in the reporting period. The expense for streamers and prizes represents the amount used during the reporting period

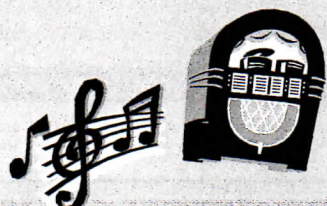
Complete this flow chart of the single entry accounting process so far:



Statement of Receipts and Payments		
	\$	\$
Cash at start		(330)
Add Cash Receipts		
Fees	3000	
GST received	300	3300
		2970
Less Cash Payments		
Drawings	900	
Postage	30	
Advertising	400	
Streamers & Prizes	500	
CD's	180	
Stationery	60	
Vehicle Fuel	300	
Loan Mrs Rap	500	
GST Paid	147	3017
Cash at end		(47)

Calculation of streamers & prizes expenses	
	\$
Stock at start	250
+ stock purchased	500
Sub total	750
- stock at end	90
Stock expense	640

Profit/Loss Statement		
Revenue	\$	\$
Fees		3000
Less Expenses		
Postage	30	
Advertising	400	
Streamers and Prizes	640	
CD's	180	
Fuel	300	1550
Net Profit		1450



If expenses exceeded revenue this would be called a **LOSS**. State the effect of this **LOSS** on the owners equity section of the Balance Sheet. will reduce owners equity

Net GST payable schedule for May	
	\$
GST owing to ATO at 1/5	420
+ GST received	300
Sub Total	720
Less GST paid to suppliers	147
GST owing to ATO	573

The change in the cash balance as reported in the Statement of Receipts and Payments is not the same as the profit or loss as reported in the Profit/Loss Statement; explain why.

It is simply the difference between the opening bank balance at the start of the reporting period and the bank balance at the end of the reporting period

Explain why profit is added to capital in the Balance Sheet.

Because it is owed to the owner and it increases the value of capital

Balance Sheet		
Assets	\$	\$
Vehicle	11 000	11000
Turntable	2000	
Speakers	1500	
CD Unit	900	
Stock of streamers	90	
Amplifier	6000	
Stock of CD's	6080	
Lights	1650	
Trailer	500	
Microphone	250	29470
Liabilities		
Overdraft	47	
Loan MAB	5000	
Loan Mrs Rap	2500	
GST Payable	573	8120
Owners Equity		
Capital	20 300	
+ party lights	500	
+ profit	1450	
- drawings	900	21550
		29470

Use the following information to prepare a Profit and Loss Statement for November 2015. I purchase CDs during the month to help me provide my services.



Data for November 2015	
Item	\$
Loan from ANZ Bank	10000
Insurance expense	600
CDs purchased	190
GST received from customers	550
Service fees	5500
Vehicle expenses	120
Stock of CDs 1/11	2400
Stock of CDs 30/11	2000
GST paid to suppliers	131
Vehicle	25000
Administration expenses	400

Calculation of CDs expense for November 2015

Stock 1/11	2400
+ Purchases	190
	<u>2590</u>
- Stock 30/11	<u>2000</u>
CD expense	590

Funky Franky. Profit and Loss Statement for November 2015		
Revenue		
Service Fees		5500
Expenses		
Insurance	600	
Vehicle Exp	120	
Admin Exp	400	
CD Exp	590	1710
Profit		3790

There are more lines in this Profit and Loss Statement than you will use!

Your Profit and Loss Statement reports on revenues and expenses. GST received from customers, \$550, is not a revenue item and GST paid to suppliers, \$131, is not an expense item: thus these two items are excluded from the Profit and Loss Statement. Further, you should not include loan from ANZ Bank, 10000, which is a LIABILITY and you should not include vehicle, \$25000, which is an ASSET. You should get a profit of \$3790!



Funky Franky. Profit and Loss Statement		
		\$
Profit		3790
CDs expense		590
Insurance		600
Service fees		5500
Admin. expenses		400
Vehicle expenses		120

Accounting reports should be UNDERSTANDABLE by the users of those reports: this is one of the qualitative characteristics of the accounting reports. Consider the Profit and Loss Statement on the left. It contains the correct profit/loss data for November but is not very 'understandable' given the way the data is presented. Further, note that the report does not contain any information about the period of time over which profit or loss is calculated. Because the report does not give information about the REPORTING period, it also does not make the report understandable to the user.



Understandability

Classified Balance Sheets



The information in Balance Sheets can be improved by classifying the assets and liabilities. Consider the following Balance Sheet of **Mick's Joy Flights**.



Mick's Joy Flights: Balance Sheet at 31/12/14.				
Assets	\$	Equities	\$	\$
Cash	5800	Liabilities		
Stock of fuel	6500	GST payable	3000	
Cash on hand	50	Loan due 1/3/15	4000	
Office computer	2600	Loan due 1/3/20	15000	22000
Helicopter	90000	Owners Equity		
Office Equipment	15000	Capital, Mick		97950
Total Assets	119950	Total Equities		119950

Assets are resources controlled by the business as a result of past events and from which future ECONOMIC benefits are expected to flow to the business. Assets can be further classified as either CURRENT or NON current assets. Current assets are those resources controlled by the business which are cash or those that are expected to be used up or converted to cash within 12 months. In the above example, current assets are cash, stock of fuel and cash on hand. Non Current assets are those resources controlled by the business that are expected to assist the business generate its REVENUE for more than 12 months. In the above example, non current assets are office computer, helicopter and office equipment. **Complete the asset section of the Balance Sheet below.**



Mick's Joy Flights: Balance Sheet at 31/12/14.					
Assets	\$	\$	Equities	\$	\$
Current Assets			Liabilities		
Cash	5800		Current Liabilities		
Stock of fuel	6500		GST Payable	3000	
Cash on hand	50	12350	Loan 1/3/15	4000	7000
Non Current			Non Current Liabilities		
Office computer	2600		Loan 1/3/20	15000	15000
Helicopter	90 000		Total Liabilities		22000
Office Equipment	15 000	107 600	Owners Equity		
			Capital, Mick		97950
Total Assets		119 950	Total Equities		119950



Liabilities are often referred to as future SACRIFICES of future economic benefits that the business is obliged to make to other entities. Liabilities can be further classified into either CURRENT liabilities or non current liabilities. Current liabilities are those sacrifices that the business expects to make within the next 12 months. In the above example, current liabilities are the GST payable (to the ATO) and the loan which is due on 1/3/15. Non current liabilities are those sacrifices that the business does not expect to make within the next 12 months. In the above example there is one non current liability; the loan which is not due until 1/3/20. **Complete the liabilities section in the above Balance Sheet.**



By themselves, the working capital (WC) and working capital ratio (WCR) can be PERFORMANCE indicators of liquidity. These liquidity indicators only represent the relationship between current assets (CA) and current liabilities (CL) at a point in time, the date of the BALANCE Sheet, and do not provide information about the CAPITAL or characteristics of CA and CL or about expected cash inflows/receipts and cash outflows/payments in the short term.

Consider the following:

Balance Sheet (extract) at 31/12/15		
	\$	\$
Current Assets		
Stock of parts		5000
Current Liabilities		
GST payable (Jan.)	2000	
Cash overdraft	2500	4500

Investigation tells us that the business has an overdraft limit of \$2500 and that it will not be increased. Further, wages of \$3000 are due in three days and a new competitor has recently opened in the area.

Calculate WC at 31/12/15

$$WC = CA - CL$$

$$5000 - 4500$$

$$WC = 500$$

Calculate WCR at 31/12/15

$$WCR = CA / CL$$

$$5000 / 4500$$

$$= 1.1 : 1$$

Comment on the business's liquidity.

The business is liquid. They have \$1.10 of assets for every \$1 of liabilities.

They are able to meet their short term debts

Given the information below, calculate the WC and WCR and then comment on the business's liquidity.



Balance Sheet (extract) at 30/6/17		
	\$	\$
Current Assets		
Stock of parts	3000	
Cash	5000	8000
Current Liabilities		
Loan (1/5/18)	9000	
GST payable	1500	10500

Investigation tells us that the business has an overdraft limit of \$20000. Further, no cash expenses or drawings is expected in the short term and a competitor has recently closed in the area.

Calculate WC at 31/6/17

$$(2500)$$

Calculate WCR at 31/6/17

$$0.76 : 1$$

Comment on the business's liquidity.

Liquidity is poor.

They are unable to meet their short term debts



The last two examples provide evidence that the WC and WCR can be poor indicators of a business's short term liquidity. In order to more accurately assess the business's short term liquidity we would need assess to data such as the components and characteristics of CA and CL as well as expected CASH receipts and cash PAYMENTS in the short term. Information about the cash OVERDRAFT facility would also be useful.

Chapter 3: Classification

Here is my unclassified Balance Sheet at 1/1/17 and my cashbook for January 2017. Use this data to calculate profit or loss for January (not a formal Profit and Loss Statement) and a classified Balance Sheet at 31/1/17.



Karl the Carpenter: Balance Sheet at 1/1/17			
ASSETS	\$	EQUITIES	\$
Stock of materials	7000	GST payable to ATO	700
Cash	5000	ANZ loan	15000
Cash in tin	50	Capital, Karl	46350
Truck	35000		
Equipment	15000		
Total Assets	62050	Total Equities	62050

Cash Receipts									
These columns exclude GST									
Date	Details	Rec.	Capital	Takings	Sundry	Loan		GST from customers	Bank
31/1	Totals	-	9000	15000				1500	25500

Cash Payments									
These columns exclude GST									
Date	Details	Chq.	Materials	Wages	Insurance	Advert.	Drawings	GST to suppliers	Bank
31/1	Totals	-	2400	800	150	690	1500	324	5864

A stock take of materials at the end of January was valued at \$5800.

\$3000 of the ANZ Loan is payable in the next 12 months.

Calculation of materials expense for January 2017	
stock at start	7000
+ purchases	2400
	9400
- stock at end	5800
Expense	3600

Calculation of Net GST payable at 31/1/17	
GST payable	700
+ GST received	1500
	2200
- GST paid	324
= GST payable	1876

Calculation of profit or loss for January 2017			
Revenue	15000	Expenses	
- Expenses	5240	3600	
		800	
		150	
Profit	9760	690	

Calculation of cash balance at 31/1/17	
cash at start	5000
+ Receipts	25500
	30500
- payments	5864
= cash at end	24636

Karl the Carpenter: Balance Sheet at 31/1/17					
Assets	\$	\$	Equities	\$	\$
Current Assets			Liabilities		
Stock materials	5800		Current Liabilities		
Cash	24636		GST payable	1876	
Cash in tin	50	30486	ANZ loan	3000	4876
Non current			Non current		
Truck	35000		ANZ loan	12000	12000
Equipment	15000	50000			
			Owners Equity		
			Capital	46350	
			+ capital contribution	9000	
			+ profit	9760	
			- drawings	1500	63610
		80486			
					80486

Vertical and horizontal analysis



Information such as the data in accounting reports can be presented in a variety of different ways. The aim is usually to clarify information or to emphasize information which is considered particularly important. **Consider the following Profit/Loss Statement.**

KPIs

Profit/Loss Statement for October 2016		
Revenue	\$	\$
Takings		25000
Less Expenses		
Materials	9000	
Wages	6000	
Rent	4000	
Interest	1000	20000
Profit		5000

Profit/Loss Statement for October 2016		
Revenue	\$	%
Takings	25000	100
Less Expenses		
Materials	9000	36
Wages	6000	24
Rent	4000	16
Interest	1000	4
Total expenses	20000	80
Profit	5000	20

This is the same Profit/Loss Statement but it has been presented in such a way as to show the relevant importance of each item to Revenue or Takings. Materials expense, for example, represents 36% of each dollar of revenue, wages represents 24% of each dollar of revenue etc. Total expenses take up 80% of each dollar of revenue leaving 20% of each dollar of revenue as profit.

The percentage data shown in the Profit/Loss Statement are often used as key performance indicators (KPIs) to monitor and assess business performance. Two of the percentages are of particular importance.



- 1. Return on Revenue (ROR).** This ratio, 20% in the above example, measures the relationship between profit and revenue, or the profit generated for every dollar of revenue. The ROR is sometimes called the Net Profit Ratio.
- 2. Total Expenses Ratio. (TER).** This ratio, 80% in the above example, measures the relationship between total expenses and revenue, or the total expenses for every dollar of revenue. Of course the TER is a function of the individual expenses such as materials, wages, rent etc.

ROR

TER

When the Profit/Loss Statement is presented with percentage data as shown in the above example, it is often referred to as VERTICAL analysis since the percentage data is presented vertically allowing quick comparison of each item in the Profit/Loss Statement. When two or more statements are presented side by side, as in the example below, it is often called HORIZONTAL analysis. Horizontal analysis, using percentage data, allows quick comparison of key performance indicators, such as the ROR and TER over time.

Profit/Loss Statement for October 2016			Profit/Loss Statement for November 2016			Profit/Loss Statement for December 2016		
Revenue	\$	%	Revenue	\$	%	Revenue	\$	%
Takings	25000	100	Takings	24000	100	Takings	24000	100
Less Expenses			Less Expenses			Less Expenses		
Materials	9000	36	Materials	7000	29	Materials	7000	29
Wages	6000	24	Wages	6000	25	Wages	9500	40
Rent	4000	16	Rent	4000	17	Rent	4000	17
Interest	1000	4	Interest	1000	4	Interest	1000	4
Total expenses	20000	80	Total expenses	18000	75	Total expenses	21500	90
Profit	5000	20	Profit	6000	25	Profit	2500	10



In November even though Takings decreased by \$1000, the ROR increased favourably from 20% to 25%. This favourable trend was due to the decrease/increase in the TER from 80% to 75%. The major cause of this improved expense performance was the decrease in the MATERIALS expense from \$9000 to \$7000 which caused the materials expense ratio to improve from 36% to 29%. In December the ROR decreased unfavourably from 25% to 10%. This trend is largely due to the decrease/increase in total expenses from \$18000 to \$21500 which is reflected in the TER changing unfavourably from 75% to 90%. The major reason for this change is the increase in WAGES from \$6000 to \$9500 which is shown by the wages expense ratio changing unfavourably from 25% to 40%.