

Figure 3.5 summarises how to record an increase or decrease in each type of ledger account:

Figure 3.5 Summary of ledger entries

Type of Account	Increase	Decrease
Asset	Debit side	Credit side
Liability	Credit side	Debit side
Owner's equity	Credit side	Debit side
Revenue	Credit side	Debit side
Expense	Debit side	Credit side

Recording procedure

Until these recording rules become second nature (which they will – and, in fact, must!), it may be worthwhile to follow the four simple steps outlined below:

Step 1: Identify the items/accounts affected. (Remember there will be at least two.)

Step 2: Identify what type of accounts they are – A / L / Oe / R / E.

Step 3: Identify whether they are increasing or decreasing.

Step 4: Use the table to identify whether the account should be debited or credited.

This procedure is best followed by completing what is known as an *Analysing chart*. The Analysing chart for the four transactions described earlier is shown in Figure 3.6:

Figure 3.6 Analysing chart

Date	Accounts affected	Type of account	Increase/Decrease	Debit \$	Credit \$
Jan. 1	Bank	Asset	Increase	40 000	
	Capital	Owner's equity	Increase		40 000
Jan. 2	Stock Control	Asset	Increase	12 000	
	Creditors Control	Liability	Increase		12 000
Jan. 3	Bank	Asset	Increase	20 000	
	Loan – Sunbank	Liability	Increase		20 000
Jan. 4	Van	Asset	Increase	15 000	
	Bank	Asset	Decrease		15 000
Jan. 5	Bank	Asset	Increase	600	
	Commission revenue	Revenue	Increase		600
Jan. 6	Bank	Asset	Increase	1 200	
	Wages	Expense	Increase		1 200

Swap words around.

Swap words around.

Should read "Decrease".

Move numbers up and down as shown.

By convention, the debit entry is shown first, and the second entry is shown to emphasise that it is the credit entry.

Note: The analysing chart is not an actual accounting record – it is simply a tool you may use until you learn the ledger entries (sort of like training wheels when you learn to ride a bike). When you feel that you know the ledger rules (and can balance on your own two wheels!), you can stop using the analysing chart and record the transactions straight into the ledger accounts.

Review questions 3.4

- 1 Referring to their relationship to owner's equity, **explain** why:
 - revenue accounts increase on the credit side
 - expense accounts increase on the debit side.
- 2 **Draw** a table to summarise the rules for recording in ledger accounts.

3.5 SOME CHALLENGING ENTRIES

Opening balances

When ledger accounts are started for a business that has already been trading for some time, there will be pre-existing balances for items in its reports. These balances must be entered in the ledger accounts before any new transactions can be recorded. The normal rules for recording in ledger accounts still apply – increase assets on the debit side, liabilities and owner's equity on the credit side etc. However, the balances in each account will be the product of a number of different transactions, and thus will not be traceable to one single account – this means that the cross-reference can be stated as simply *Balance*.

The assets and equities of Mickelham Frames as at 1 July 2010 were as follows:

Bank	\$1 000	Creditors Control	2 000
Stock Control	4 000	Capital – Malloy	23 000
Shelving	17 000		

EXAMPLE

Even when entering opening balances, a proper double-entry must still be recorded.

ANALYSING CHART

Date	Accounts affected	Type of account	Increase/Decrease	Debit \$	Credit \$
July 1	Bank	Asset	Increase	1 000	
	Stock Control	Asset	Increase	4 000	
	Shelving	Asset	Increase	17 000	
	Creditors Control	Liability	Increase		2 000
	Capital	Owner's equity	Increase		20 000

Should read "20 000".

Figure 3.7 shows how these opening balances would be entered in the ledger accounts:

Figure 3.7 Opening balances in the General Ledger

GENERAL LEDGER

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	1 000			

Stock Control (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
July 1	Balance	4 000			

Figure 4.10 Recording a credit sale with GST in the General Ledger**Debtors Control (A)**

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Apr. 1	Balance	6 000			
Apr. 21	Sales/GST Clearing	2 200			

Sales (R)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Apr. 7	Bank	40
			21	Debtors Control	2 000

GST Clearing (A or L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Apr. 14	Bank	120	Apr. 7	Bank	40
			21	Debtors Control	2 000

Stock Control (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Apr. 1	Balance	15 000	Apr. 7	Cost of sales	250
			21	Cost of sales	1 250

Cost of sales (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Apr. 7	Stock control	250			
21	Stock control	1 250			

The \$2200 owed by the debtors includes the \$2000 for the sale, plus \$200 GST, so the cross-reference in the Debtors Control account refers to both Sales and GST Clearing. However, the GST is charged to the debtor on behalf of the ATO, so it is credited to GST Clearing to increase the liability owed to the ATO.

Effect on the Accounting equation

A credit sale with GST has the following effect on the Accounting equation:

	Increase/Decrease/No effect	Amount \$
Assets	Increase (increase Debtors Cont. \$2200, decrease Stock Cont. \$1250)	950
Liabilities	Increase (GST Clearing)	200
Owner's equity	Increase (Sales \$2000 less Cost of Sales \$1250 = Profit)	750

Should read "200".

Recording a credit purchase with GST

As a result of a credit purchase, we will owe the supplier for both the stock, and the GST incurred, but the items are separate: the GST does not affect the cost price of the stock purchased. The ledger entries to record a credit purchase with GST would thus be:

DR.	Stock Control	\$2 700
DR.	GST Clearing	270
CR.	Creditors Control	2 970

This entry would be recorded in the General Ledger as is shown in Figure 4.12:

Figure 4.12 Recording a credit purchase in the General Ledger

Stock Control (A)					
Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Apr. 1	Balance	15 000	Apr. 7	Cost of sales	250
Apr. 28	Creditors Control	2 700	Apr. 21	Cost of sales	1 250

GST Clearing (A or L)					
Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Apr. 14	Bank	120	Apr. 7	Bank	40
Apr. 28	Creditors Control	270	Apr. 21	Debtors Control	2 000

Creditors Control (L)					
Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
			Apr. 1	Balance	7 000
			Apr. 28	Stock Control/GST Clearing	2 970

Should read "200".

The \$2970 owed to creditors includes the \$2700 for the stock, plus \$270 GST, so the cross-reference in the Creditors Control account refers to both **Stock Control** and **GST Clearing**; both accounts are linked to Creditors Control, because the business owes the creditors both amounts. The GST incurred (\$270) will reduce our GST liability to the ATO, and so it is debited to the GST Clearing account.

Effect on the Accounting equation

A credit purchase of stock will thus have the following effect on the Accounting equation:

	Increase/Decrease/No effect	Amount \$
Assets	Increase (Stock Control \$2700)	2 700
Liabilities	Increase (increase Cred. Control \$2970, decrease GST Clear. \$270)	2 700
Owner's equity	No effect	

Study tip

Although invoices would be issued for credit purchases of all items – stock and non-current assets alike – Unit 3 only covers credit purchases of stock.

Review questions 8.7

- Explain** why a stock loss is classified as an expense.
- Identify** three reasons for a stock loss.
- Show** the General Journal entries necessary to record a stock loss.
- State** the effect of a stock loss on each element of the Accounting equation.

Stock gain –

a revenue earned when the stocktake shows a figure for stock on hand which is more than the balance shown in the stock card

Study tip

Stock gain is a good reminder that revenue does not need to be cash; in this case stock is the asset that has increased, with no effect on cash whatsoever.

8.8 STOCK GAINS

Where the number of units counted by the stock take is *more* than the quantity shown in the balance of the stock card, a **stock gain** has occurred.

This may be due to:

- oversupply from a supplier – a supplier has sent us stock for which we have not been charged
- undersupply to a customer – we have charged a customer for stock which we have not delivered (and the customer has not realised!).

Should read "35".

Recording a stock gain

A stock gain means that there is more stock available for sale than is currently shown in the stock card and Stock Control account, so the quantity gained must be recorded in the IN column of the stock card, and as a debit in the Stock Control account. In addition, the stock gain itself is a revenue item – an inflow of an economic benefit in the form of an increase in assets (stock on hand), leading to an increase in owner's equity, and this must also be shown in the ledger.

EXAMPLE

On 31 October 2010, the stock take revealed there are **56 pairs of gardening gloves on hand** (Memo 31). The stock card for gloves shows a balance of **48 pairs**, so a stock gain of **8 pairs** has been detected.

This stock gain would be recorded in the IN column of the stock card as shown in Figure 8.4.

Figure 8.4 Recording a stock gain in the stock card

Should read "27".

STOCK CARD

Stock Item: Gardening Gloves		Location: Row 21, Bay A5								
Stock Code: G10		Supplier: Amsten Products								
Date	Details	IN			OUT			BALANCE		
		Qty	Unit cost	Value	Qty	Unit cost	Value	Qty	Unit cost	Value
Oct. 1	Balance							22	10	220
15	Inv. 30A	30	12	360				22	10	220
								30	12	360
23	Rec. 30				22	10	220			
					3	12	36	27	12	324
31	Memo 31	5	10	50				5	10	50
		3	12	36				30	12	360

Study tip

For a stock gain, use the cost price in the most recent OUT transaction.

If the \$1200 payment made on 1 October 2010 covers 12 months, then 1 month of insurance is \$100 ($1/12$ of \$1200). That is, by balance day of 31 October 2010, one month – \$100 – of prepaid insurance has been consumed.

The balance day adjustment to record the insurance consumed is shown in the General Journal entry in Figure 10.1:

Figure 10.1 Balance day adjustment for consumption of prepaid insurance

GENERAL JOURNAL

Date	Details	General Ledger		Subsidiary Ledger	
		Debit \$	Credit \$	Debit \$	Credit \$
Oct. 31	Insurance expense	100			
	Prepaid Insurance		100		
	Adjusting entry to record one month insurance incurred (Memo 9)				

Study tip

Calculate the amount consumed/used up/incurred – this is the amount to use in the adjustment.

This entry debits the Insurance expense account to recognise the expense incurred in the current Reporting period, while the Prepaid insurance account is credited to reduce the current asset by the amount consumed.

Posting this entry to the General Ledger would show:

GENERAL LEDGER

Prepaid insurance (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 31	Bank	1 200	Oct. 31	Insurance expenses	100

Insurance expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Oct. 31	Prepaid insurance	100			

Should read "1 100".

Note that the General Journal entry to record the balance day adjustment uses the amount consumed in the current Reporting period. The balance left in the Prepaid rent account ($\$1200 - \$100 = \$1100$) represents the amount unused, or the amount that will be consumed in a future Reporting period. This is the new current asset balance.

Effect on the Accounting equation

As a result of the adjustment for prepaid insurance consumed:

	Increase/Decrease/No effect	Amount \$
Assets	Decrease (Prepaid insurance)	100
Liabilities	No effect	
Owner's Equity	Decrease (Increase Insurance expense, which decreases Net profit)	100

This adjustment does not change Bank, nor does it affect GST Clearing; it changes the calculation of profit, and one other item in the Balance Sheet.

\$150 worth of GST, which must be debited to GST Clearing. This leaves us with \$1500 that has been paid for electricity. But how much relates to electricity that was consumed in November?

Remember that on 31 October 2010, we made a balance day adjustment to record \$300 of electricity that had been consumed in October, but was not yet paid. That is, at 31 October 2010, \$300 was owed for Accrued electricity. So when the payment is made on 4 November 2010, some of the \$1500 is being used to pay off this earlier debt. That is, \$300 is paid to decrease Accrued electricity, so only \$1200 represents electricity consumed during November. Once the Cash Payments Journal has been posted to the General Ledger, the accounts would show:

GENERAL LEDGER

Bank (A)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 30	Balance	4 000	Nov. 30	Cash payments	16 350

Should have an entry reading "Nov.1 Balance 300".

Electricity expense (E)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 30	Bank	1 200			

Accrued electricity (L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 30	Bank	300			

GST Clearing (A/L)

Date	Cross-reference	Amount \$	Date	Cross-reference	Amount \$
Nov. 30	Bank	150	Nov. 1	Balance	850

As has been noted, not all expenses incur GST; when paying a non-GST item (like Wages or Interest expenses) in a subsequent period, it will not be necessary to account for the GST. (However, it is likely that it will still be necessary to split the payment as part Wages expense, part Accrued wages, or part Interest expense, part Accrued interest.)

Effect on the Accounting equation

As a result of the payment of electricity and accrued electricity:

	Increase/Decrease/No effect	Amount \$
Assets	Decrease (Bank)	1 650
Liabilities	Decrease (Accrued wages \$300, GST Clearing \$150)	450
Owner's equity	Decrease (increase Electricity expense, which decreases Net profit)	1 200

SUMMARY

- The **Statement of Receipts and Payments** reports cash received and paid during a **Reporting period**, and the change in the firm's bank balance over that period.
- The **Cash Flow Statement** reports cash inflows and cash outflows separately identifying cash flows relating to **Operating Activities**, **Investing Activities**, and **Financing Activities**.
- **Operating activities** are cash flows related to day-to-day trading activities.
- **Investing activities** are cash flows related to the purchase and sale of non-current assets.
- **Financing activities** are cash flows related to changes in the financial structure of the firm.
- A cash surplus occurs when cash receipts exceed cash payments, leading to an increase in the bank balance.
- A cash deficit occurs when cash payments exceed cash receipts, leading to a decrease in the bank balance.
- The **Cash Flow Statement** is used to aid decision-making and planning.
- There are four potential cash flows related to **GST**: **Operating Inflows – GST received**, **GST paid**, **Operating Outflows – GST refund**, **GST settlement**.
- **Cash and profit** are different measures of performance, and there are many possible reasons why a firm that is earning a profit can still suffer from a lack of cash.
- Some cash receipts are not revenues.
- Some cash payments are not expenses.
- Some revenues are not cash receipts.
- Some expenses are not cash payments.
- Some items affect both cash and profit, but by differing amounts.

Swap

Recording the stock write down

Remember, at the time of purchase stock is recorded at its cost. If the stock must be written down to its NRV, then both the stock card and the General Ledger must be adjusted. The stock card (for dishwashers) must record the write down *per item*, as is shown in Figure 14.7:

Figure 14.7 Recording a stock write down in the stock card

STOCK CARD

Stock Item:		Golf bags								
Date	Details	IN			OUT			BALANCE		
		Qty	Unit cost	Value	Qty	Unit cost	Value	Qty	Unit cost	Value
Aug. 1	Inv. 29	10	550	5 500				10	550	5 500
8	Rec. 17				4	550	2 200	6	550	3 300
31	Memo 31				6	70	420	6	480	2 880

Notice that even though this entry is recorded in the OUT column of the stock card, no units of stock are actually leaving the business; stock has been reduced in *value*, not in *quantity*. Each dishwasher is written down by \$70, leaving each one valued at its NRV of \$480 (\$550 cost price less \$70 stock write down).

The General Journal entry to record the write down of stock its NRV is shown in Figure 14.8:

Figure 14.8 Recording a stock write down in the General Journal

GENERAL JOURNAL

Date	Details	General Ledger		Subsidiary Ledger	
		Debit	Credit	Debit	Credit
Aug. 31	Stock write down	420			
	Stock Control		420		
	Write down of stock to NRV due to release of new model (Memo 31)				

Stock write down is debited to recognise the expense – the loss of an economic benefit in the form of a reduction in assets (stock), which decreases owner's equity. At the same time, the asset Stock Control is credited to recognise that the asset is no longer worth its Historical cost.

This General Journal entry would be posted to the General Ledger as is shown in Figure 14.9:

Study tip

The amount used in the General Journal entry is the amount of the write down, not the new balance of stock on hand.

Required

- Record** the cash received in the Cash Receipts Journal of Sol's Small Goods.
- Referring to one Accounting principle, **explain** why only part of the rent received should be recognised as revenue for the year ended 30 June 2010.
- Calculate** the Rent revenue earned for the year ending 30 June 2010.
- Show** the General Journal entries necessary to record Rent revenue earned for the year ending 30 June 2010.
- State** the effect of the adjustment for Rent revenue on each element of the Accounting equation.
- Show** how the Rent revenue and Prepaid rent revenue accounts would appear in the General Ledger of Sol's Small Goods as at 30 June 2010 after all closing and balancing entries have been made.

Exercise 16.2 Prepaid sales revenue

Clink Glassware received a deposit of \$3000 (plus \$300 GST) on 16 January 2010 for a bulk order from one of its customers (Rec. 84). The goods (which had a cost price of \$2100) were delivered on 27 February 2010 (Memo 46).

Should be 'February'.

Required

- Record** the cash received in the Cash Receipts Journal of Clink Glassware.
- Explain** how the deposit would be reported in the Balance Sheet of Clink Glassware on 31 January 2010.
- Show** the General Journal entries necessary to record Sales revenue earned for January 2010.
- State** the effect of the adjustment for Sales revenue earned on each element of the Accounting equation.
- Show** how the Sales revenue, Prepaid sales revenue and Cost of sales accounts would appear after the General Journal was posted to the General Ledger.

Exercise 16.3 Prepaid sales revenue

During December 2009, Terry's Newsagency received yearly magazine subscriptions worth \$72 000 (plus \$7200 GST) for magazines to be delivered during 2010 (Rec. 107). The magazines that had been provided by 31 March 2010 had a cost price of \$12 000 (Memo 29).

Required

- State** the effect of the receipt of subscriptions on each element of the Accounting equation.
- Calculate** the Subscription revenue earned for the quarter ended 31 March 2010.
- Show** the General Journal entries necessary to record Subscription revenue earned for the quarter ended 31 March 2010.
- Show** how the Subscription revenue, Prepaid subscription revenue and Cost of sales accounts would appear in the General Ledger of Terry's Newsagency as at 31 March 2010 after all closing and balancing entries have been made.
- Explain** the effect (Overstated/Understated/No effect) on the Balance Sheet of Terry's Newsagency as at 31 March 2010 if the adjustment for Subscription revenue was *not* made.

Exercise 16.4 Prepaid sales revenue

Insensitel recently advertised for sale a new version of its award-winning Game Station console. The console is sold on a prepaid basis only, and on 13 November 2010 the business received \$4950 (including \$450 GST) in advance sales (Rec. 90). By the end of November 2010, \$3900 worth of sales (with a cost price of \$1000) had been earned (Memo 214).

Required

- Record** the cash received in the Cash Receipts Journal of Insensitel.
- Referring to one Qualitative characteristic, **explain** why the transaction on 13 November 2010 must *not* be reported as revenue.

Exercise 17.11 Cash variance report

Simply Stunning sells hair-care products to hairdressers in Melbourne and has provided the following Cash Variance Report for the year ended 30 June 2010:

Should be '99 200'.

SIMPLY STUNNING**Cash Variance Report for the year ended 30 June 2010**

Should be '89 200'.

	Budgeted	Actual	Variance	Fav/Unfav
Operating Activities				
Receipts from debtors	100 000	90 000		
Cash Sales	85 000	94 000		
GST received	16 500	19 400		
Payments to creditors	(115 000)	(136 000)		
Prepaid rent	(12 000)	(15 000)		
GST paid	(1 440)	(1 590)		
Wages	(30 000)	(26 000)		
Advertising	(2 400)	(900)		
Interest expense	(2 700)	(3 100)		
GST Settlement	(3 700)	(4 600)		
Net Operating Cash Flows	33 460	15 410		
Investing Activities				
Cash sale of Equipment	5 000	3 000		
Shelving	–	(12 000)		
Net Investing Cash Flows	5 000	(9 000)		
Financing Activities				
Capital Contribution	–	20 000		
Loan	(5 000)	–		
Drawings	(36 000)	(40 000)		
Net Financing Cash Flows	(41 000)	(20 000)		
Net Increase (Decrease) in Cash	(2 540)	(13 590)		
Opening Cash Balance	8 500	8 500	–	–
Closing Cash Balance	5 960	(5 090)		

NOTE:
This will not affect the Variance the students are required to calculate, as the difference is \$10 000 using either set of figures.

Sophie had organised an overdraft limit with the bank of \$6 000.

Required

- Explain one benefit of preparing a Cash Variance Report.
- Complete the Cash Variance Report for Simply Stunning for the year ended 30 June 2010.
- State whether the variance in Payments to creditors is favourable or unfavourable. Justify your answer.
- Suggest one possible reason for the capital contribution.
- Explain the effect on the actual Closing Bank Balance of the variance in Investing Activities.
- Identify two assets that will differ as at 30 June 2010 as a consequence of the variances in the Cash Variance Report. Justify each response.