Solutions Manual for Financial Accounting 8th Edition by Carlon, McAlpine, Lee, Mitrione

ISBN: 9781394334001

Solutions manual

to accompany

Financial Accounting: Reporting, analysis and decision making

8th edition

by

Carlon et al.

WILEY

Chapter 1: An introduction to accounting

Assignment classification table

Learning objectives		Brief exercises	Exercises	Problems
1.	Explain the business context and the need for decision making.		1	
2.	Define accounting, describe the accounting process and define the diverse roles of accountants.		1	
3.	Explain the characteristics of the main forms of business organisation.	1		1A,1B
4.	Understand the *Conceptual Framework* and the purpose of financial reporting.			
5.	Identify the users of financial reports and describe users' information needs.	3	1	2A; 2B
6.	Identify the elements of each of the four main financial statements.	4,5,6	1,2,3,4,5, 7, 8,9,10	3A,4A,5A,6A 7A,8A,3B,4B 5B,6B,7B,8B
7.	Describe the financial reporting environment.	2		
8.	Explain the accounting assumptions, concepts, principles, qualitative characteristics and constraints underlying financial statements		6	3A, 3B
9.	Calculate and interpret ratios for analysing an entity's profitability, liquidity and solvency.	7	11,12,13	9A,10A 9B,10B

Solutions to questions

1.1. **Describe the decision-making process.**

The first step in the process of decision making is to identify the issue or the decision to be made. The next step is to gather the relevant information required for the analysis. Once gathered, you then identify the tool or technique that can provide the analysis of the issue so a decision may be made. The final step is to evaluate the results of the analysis and make the decision. The primary function of accounting is to relevant information to aid in making a business decision.

1.2. **What are some of the financial decisions owners need to make when running a new business?**

When running a business most of your actions require decisions. Beginning with deciding which is the most suitable business structure and where are you going to locate your business and are you going to have an online presence as well, how are you going to fund your activities (borrow or have equity investors), how many employees do you need and what level of inventory is required to name a few decisions. When starting a new business deciding on the suitable accounting system and information system is important. Are you intending to have EFTPOS? Are you going to have online sales? Etc.

1.3. **What are the advantages to a business of being formed as a company? What are the disadvantages?**

Advantages of company structure are limited liability (shareholders not being personally liable for corporate debts), indefinite life, easy transferability of ownership (through selling shares), and greater ability to raise funds. Disadvantages of a company are the establishment costs and ongoing fees and increased government regulations.

1.4. **Who are the external users of accounting data? Give examples.**

External users are those outside the business who have an interest in knowing about the activities of the entity as resource providers, recipients of goods or services or parties performing a review of oversight function. Examples include investors, creditors such as banks and suppliers, taxing authorities, regulatory agencies, trade unions and customers.

1.5. **Listed here are some items found in the financial statements of Ruth Weber Ltd. Indicate in which financial statement(s) each item would appear.**

(a) Sales revenue.
(b) Office equipment.
(c) Accounts receivable.
(d) Interest expense.
(e) Share capital.
(f) Loan payable

(a) Statement of profit or loss.
(b) Statement of financial position.
(c) Statement of financial position.
(d) Statement of profit or loss.

(e) Statement of financial position.
(f) Statement of financial position.

1.6. **What is a conceptual framework and what purpose does it serve?**
The *Conceptual Framework* consists of a set of concepts to be followed by preparers of financial statements and standard setters. The *Conceptual Framework* provides guidance to preparers of financial information by defining who is required to report and who the users are likely to be.

1.7. **Why is it important to determine if a business entity is a reporting entity? Outline the three main indicators that determine if an entity is a reporting entity.**
It is important to determine if a business is a *reporting entity* as it is only reporting entities that are required to prepare general purpose financial reports in accordance with the accounting standards.
Three main indicators determine which of the forms of business organisation fall into the category of a reporting entity. That is, an entity is more likely to be classified as a reporting entity if it is (1) managed by individuals who are not owners of the entity, (2) politically or economically important, and (3) sizable in any of the following ways — sales, assets, borrowings, customers or employees.

1.8. **What are the three main categories of the statement of cash flows? Why do you think these categories were chosen?**
The three categories in the statement of cash flows are operating activities, investing activities and financing activities. The categories were chosen because they represent the three principal types of business activity.

1.9. **What is retained earnings? What items increase the balance in retained earnings? What items decrease the balance in retained earnings?**
Retained earnings is the profit retained in a company. Retained earnings is increased by profit and is decreased by dividends and by losses.

1.10. **What purpose does the going concern assumption serve?**
The going concern assumption lends credibility to the historical cost principle; otherwise items would be reported at liquidation value. By assuming the entity will continue to operate, assets can continue to be reported at cost because they are expected to bring benefits to the business through use even though they may have little or no resale value.

1.11. **Shirl Lee, the managing director of Whitegoods Pty Ltd, is pleased. Whitegoods substantially increased its profit in 2025 while keeping its unit inventory relatively the same. Rose Ena, chief accountant, cautions Shirl Lee, explaining that since Whitegoods changed its method of inventory valuation, there is a comparability problem and it is difficult to determine whether Whitegoods is better off. Is Rose correct? Why or why not?**
Rose Ena is correct. Comparability means that financial statements can be compared between companies and over time. Using the same accounting principles and accounting methods from period to period with a company, facilitates comparability. When accounting methods are inconsistent, it is difficult to determine whether a company is better off, worse off or the same from period to period.

1.12. **What is meant by the term *operating cycle*?**

A company's operating cycle is the average time taken to acquire goods and services and convert them to cash in producing revenues.

1.13. **(a) Tia Kim believes that the analysis of financial statements is directed at two characteristics of an entity: liquidity and profitability. Is Tia correct? Explain.**
(b) Are short-term creditors, long-term creditors, and shareholders mainly interested in the same characteristics of an entity? Explain.

(a) Tia is not correct. There are three characteristics:
- liquidity
- profitability
- solvency.

(b) The three parties are not primarily interested in the same characteristics of a company. Short-term creditors are primarily interested in the liquidity of the business. In contrast, long-term creditors and shareholders are primarily interested in the profitability and solvency of the company. However, they may use the same financial statements as a source of information.

1.14. **Holding all other factors constant, indicate whether each of the following signals generally good or bad news about an entity.**
(a) Increase in the profit margin.
(b) Increase in the current ratio.
(c) Decrease in the debt to total assets ratio.
(d) Increase in the current cash debt coverage.

(a) The increase in profit margin is good news because it means that a larger percentage of profit is generated for each dollar of net sales.

(b) An increase in the current ratio generally signals good news because the company improved its liquidity.

(c) The decrease in the debt to total assets ratio is good news because it means that the company has decreased the proportion of assets funded by creditors, thus reducing risk of being unable to repay debt.

(d) An increase in current cash debt coverage ratio is good news because it means that the company has increased its ability to meet short-term obligations. The higher the current cash debt coverage the more favourable is the liquidity of the business.

Solutions to brief exercises

BE1.1 Explain the characteristics of the main forms of business organisation. (LO3)
Match each of the following forms of business organisation with a set of characteristics: sole proprietorship (SP), partnership (P), company (C).

(a)	P	Shared control, increased skills and resources.
(b)	SP	Simple to set up and maintain control with founder.
(c)	C	Easier to transfer ownership and raise funds, no personal liability.

BE1.2 Describe the financial reporting environment. (LO7)

Indicate whether each statement is true or false.

(a) Accounting standards are set by the Financial Reporting Council.

(b) The ASX Listing Rules are only applicable to entities listed on the ASX.

(c) The Corporations Act is administered by the ATO.

(a) False
(b) True
(c) False

BE1.3 Identify users of accounting financial reports and describe their information needs. (LO5)
Match each of the following types of evaluation with one of the listed users of accounting information.

1. Trying to determine whether the company complied with the Corporations Act.

2. Trying to determine whether the entity can pay its obligations.

3. Trying to determine whether a major investment proposal will be cost effective.

4. Trying to determine whether the company's profit will result in a share price increase.

5. Trying to determine whether the entity should use debt or equity financing.

(a)	3	Executive directors
(b)	2	Bank managers
(c)	4	Shareholders
(d)	5	Chief Financial Officer
(e)	1	ASIC

BE1.4 Prepared a statement of financial position. (LO6)
In alphabetical order below are items for ABC Pty Ltd at 31 December. Prepare a statement of financial position following the format of figure 1.7.

Accounts payable	$32 500
Accounts receivable	10 000
Cash	30 000
Inventory	7 500
Share capital	15 000

ABC Pty Ltd
Statement of financial position
as at 31 December

Assets	
Cash	$30 000
Accounts receivable	10 000
Inventory	7 500
Total assets	47 500
Liabilities	
Accounts payable	32 500
Net assets	$15 000
Equity	
Share capital	15 000
Total equity	$15 000

BE1.5 Determine the proper financial statement. (LO6)
Indicate which statement you would examine to find each of the following items: statement of financial position (SFP), statement of profit or loss (P/L) or statement of cash flows (SCF).

P/L (a) Revenues during the period.
SFP (b) Accounts receivable at the end of the year.
SCF (c) Cash received from borrowing during the period.
SCF (d) Cash payments for the purchase of property, plant and equipment.

BE1.6 Prepare the assets section of a classified statement of financial position. (LO6)
A list of financial statement items for Swift Ltd includes the following: accounts receivable $15 000; prepaid rent $1000; cash $4500; supplies $2000; short-term investments $12 000; property, plant and equipment $40 000. Prepare the asset section of the statement of financial position, showing appropriate classifications.

Swift Ltd
Statement of financial position (Partial)

Current assets:	
Cash	$4,500
Short-term investments	12,000
Accounts receivable	15,000
Supplies	2,000
Prepaid rent	1,000
Total current assets	34,500
Non-current assets:	
Property, plant and equipment	40,000
Total non-current assets	40,000
Total assets	$74,500

BE1.7 Calculate return on assets and profit margin. (LO9)
The following information is available for Ware Ltd for 2025: sales revenue $7 840 000; cost of sales $3 528 000; profit $1 176 000; total equity $2 233 300; average total assets $5 113 000. Calculate the return on assets and profit margin for Ware Ltd for 2021.

Ware Ltd

Return on assets ratio $= \dfrac{\text{Profit}}{\text{Average total assets}} = \dfrac{\$1,176,000}{\$5,113,000} = 23\%$

Profit margin ratio $= \dfrac{\text{Profit}}{\text{Sales}} = \dfrac{\$1,176,000}{\$7,840,000} = 15\%$

Solutions to exercises

E1.1 Match items with descriptions. (LO1, 3, 5, 6)
Here is a list of words or phrases discussed in this chapter.
1. Auditor's opinion
2. Accounts payable
3. Accounts receivable
4. Sole trader
5. Partnership
6. Decision
7. Company
8. Equity investors
9. Share capital
Required
Match each word or phrase with the best description of it.
_______________ (a) An expression about whether financial statements are presented in a reasonable fashion.
_______________ (b) Obligations to suppliers of goods.
_______________ (c) The portion of equity that results from contributions from investors.
_______________ (d) An entity that raises money by issuing shares.
_______________ (e) Amounts due from customers.
_______________ (f) People who make decisions to buy, hold, or sell shares.
_______________ (g) A person operating and owning a business with no other owners.
_______________ (h) A business that is owned jointly by two or more individuals but that does not issue shares.
_______________ (i) A choice among alternative courses of action.

(a)	1	Auditor's opinion
(b)	2	Accounts payable
(c)	9	Share capital
(d)	7	Company
(e)	3	Accounts receivable
(f)	8	Equity Investors
(g)	4	Sole trader
(h)	5	Partnership
(i)	6	Decision

E1.2 Prepare a statement of profit or loss and a calculation of retained earnings. (LO6)
This information relates to Ray's Rentals Pty Ltd for the year.

Retained earnings, 1 January 2021	$45 000
Advertising expense	1 800
Dividends paid during 2021	7 000
Rent expense	10 400
Hire revenue	70 000
Electricity expense	2 400
Wages expense	28 000
Share capital	40 000

Required
After analysing the data, prepare a statement of profit or loss and a calculation of retained earnings for the year ending 31 December.

Ray's Rentals Pty Ltd
Statement of profit or loss
for the year ended 31 December

	$	$
Revenues:		
Hire revenue		70,000
Expenses:		
Advertising expense	1,800	
Electricity expense	2,400	
Rent expense	10,400	
Wages expense	28,000	
Total expenses		42,600
Profit		$27,400

Ray's Rentals Pty Ltd
Calculation of retained earnings
for the year ended 31 December

	$
Retained earnings, 1 January	45,000
Add: Profit	27,400
	72,400
Less: Dividends	(7,000)
Retained earnings, 31 December	$65,400

E1.3 Correct an incorrectly prepared statement of financial position. (LO6)
Deanna Veale is the bookkeeper for Quality Products Ltd. Deanna has been trying to make the statement of financial position of Quality Products Ltd balance. It is finally balanced, but now she's not sure it is correct.

QUALITY PRODUCTS LTD
Statement of financial position
as at 30 June 2021

ASSETS		LIABILITIES AND EQUITY	
Cash	$15 000	Accounts payable	$15 000
Supplies	5 600	Accounts receivable	(6 000)
Inventory	28 400	Share capital	25 000
Dividends	3 000	Retained earnings	18 000
Total assets	**$52 000**	**Total liabilities and equity**	**$52 000**

Required
Prepare a correct statement of financial position.

Quality Products Ltd
Statement of financial position
as at 30 June

Assets:		
Cash		$15,000
Accounts receivable		6,000
Supplies		5,600
Inventory		28,400
Total assets		55,000
Liabilities:		
Accounts payable		15,000
Net Assets		$40,000
Equity:		
Share capital	$25,000	
Retained earnings	*15,000	40,000
Total Equity		$40,000

*$18,000 – $3,000

E1.4 Identify financial statement components and calculate profit. (LO6)
The following items were taken from White Ltd's financial statements. (All dollars are in thousands.)

____________	Retained earnings	$ 2 000	____________	Non-current borrowings	$ 22 000
____________	Cost of sales	55 700	____________	Inventories	4 500
____________	Wages expense	18 300	____________	Sales revenue	144 000
____________	Cash	11 200	____________	Accounts receivable	12 000
____________	Current payables	14 500	____________	Reserves	8 000
____________	Interest expense	8 000	____________	Income tax expense	13 700
____________	Other expense	10 300	____________	Contributed equity	30 000
____________	Depreciation	1 800	____________	Property and equipment	20 000

Required
Perform each of the following.
(a) In each case identify whether the item is an asset (A), liability (L), equity (Eq), revenue (R) or expense (Ex).
(b) Calculate profit for White Ltd for the year ended 30 June.

White Ltd

(a)

Eq	Retained earnings	$2,000
E	Cost of sales	55,700
E	Wages expense	18,300
A	Cash	11,200
L	Current payables	14,500
E	Interest expense	8,000
E	Other expense	10,300
E	Depreciation expense	1,800
L	Non-current borrowings	22,000
A	Inventories	4,500
R	Sales revenue	144,000
A	Accounts receivable	12,000
Eq	Reserves	8,000
E	Income tax expense	13,700
Eq	Contributed equity	30,000
A	Property and equipment	20,000

(b)

Calculation of profit for White Ltd
for the year ended 30 June

	$	$
Sales revenue		144,000
Expenses:		
Cost of sales	55,700	
Wages expense	18,300	
Interest expense	8,000	
Other expense	10,300	
Depreciation expense	1,800	
Income tax expense	13,700	
Total expenses		107,800
Profit		$36,200

E1.5 Calculate missing amounts. (LO6)
Here are incomplete financial statements for Road Ltd.

ROAD LTD Statement of financial position			
ASSETS		LIABILITIES AND EQUITY	
Cash	$ 10 500	Liabilities	
Inventory	15 500	Accounts payable	$ 26 000
Property	80 000	Equity	
		Contributed equity	(a)
		Retained earnings	(b)
Total assets	**$106 000**	**Total liabilities and equity**	**$106 000**

Statement of profit or loss	
Revenues	$200 000
Cost of sales	(c)
Administrative expenses, including tax	14 000
Profit	**$ (d)**

Statement of changes in equity	
Beginning retained earnings	$12 000
Profit	(e)
Less: Dividends	(8 000)
Ending retained earnings	**$45 000**

Required
Calculate the missing amounts.

Road Ltd

Note to solve the missing amounts the student needs to decide the order to solve the missing amounts
1. The Statement of changes in equity shows the ending retained earnings as $45,000 which then can be substituted into the Statement of financial position so that **(b) equals $45,000**.

2. Now (a) Contributed equity can be calculated.
Accounts payable + Contributed equity + Retained earnings = Total liabilities and equity.

$26,000 + (a) + $45,000 = $106,000
(a) = $106,000 – $45,000 – $26,000
(a) = <u>$35,000</u>

3. Items (d) and (e) are the same figure. Therefore, solve (e) first in the Statement of changes in equity
Beginning retained earnings + Profit – Dividends = Ending retained earnings

$12,000 + (e) – $8,000 = $45,000
(e) = $45,000 – $12,000 + $8,000
(e) = <u>$41,000</u>
and also **(d) equals $41,000**

4. Lastly now item (c) can be calculated
Revenue – Cost of sales – Administrative expenses = Profit

E1.6 Identify the concept or principle that has been violated. (LO8)
Cheong Pty Ltd had three major business transactions during the year.

(1) Merchandise inventory with a cost of $68 000 is reported at its market value of $100 000.

(2) The owner of Cheong Pty Ltd, Cheong Kong, purchased a computer for personal use and charged it to his expense account.

(3) Cheong Pty Ltd wanted to make its current year profit look better, so it added in sales that occurred on the first two days of the next year.

Required
In each situation, identify the assumption or principle that has been violated, if any, and discuss what should have been done.

Cheong Pty Ltd

(1) This is a violation of the historical cost principle. The inventory was written up to its market value when it should have remained at cost.

(2) This is a violation of the accounting entity concept. The treatment of the transaction treats Cheong Kong and Cheong Pty Ltd as one entity when they are two separate entities. The computer should not have been charged to the expense account. If paid for by the business, it should have been treated as a loan from the business to Cheong Kong.

(3) This is a violation of the period concept. This concept states that the economic life of an entity can be divided into artificial time periods (months, quarters or a year). By adding two more days to the year, Cheong Pty Ltd would be misleading financial statement users. In addition, the year's results would not be comparable to previous years' results, and the problem would recur in the next year. The period should have been 52 weeks or 53 at the most. Retailers often use a complete number of weeks rather than an exact year. As a 365-day year consists of 52 weeks plus one day, many retailers use 52-week periods and then, approximately every 5 years, use a 53-week year. However, this is fully disclosed for comparative purposes. For example, Woolworths Limited.

E1.7 Classify items as current or non-current, and prepare assets section of statement of financial position. (LO6)
The following items were taken from the 30 June current year consolidated statement of financial position of Maximum Energy Limited. (All dollars are in millions.)

Inventories—current	$ 199.5	Intangibles	$4 724.1
Receivables—due after 30 June 2023	70.9	Other current assets	586.6
Oil and gas assets (non-current)	742.6	Property, plant and equipment	7 997.4
Investments (long term)	49.6	Cash and cash equivalents	421.5
Other long-term financial assets	507.7	Current receivables	2 766.0
Other financial assets (short term)	280.3	Other non-current assets	41.1
Deferred tax assets (non-current)	1 093.8	Exploration and evaluation assets (non-current)	523.5
		Inventories (non-current)	43.8

Required
Prepare the assets section of a classified statement of financial position.

Maximum Energy Limited
Statement of financial position (Partial)
as at 30 June

	$M
Current assets:	
Cash and cash equivalents	421.5
Receivables	2766.0
Inventories	199.5
Other financial assets	280.3
Other current assets	586.6
Total current assets	4253.90
Non-current assets	
Receivables	70.9
Inventories	43.8
Investments (long term)	49.6
Exploration and evaluation assets	523.5
Oil and gas assets	742.6
Property, plant and equipment	7997.4
Intangibles	4724.1
Deferred tax assets	1093.8
Other financial assets	507.7
Other non-current assets	41.1
Total non-current assets	15794.50
Total assets	$20048.40

E1.8 Classify items as current or non-current, and prepare the assets section of the statement of financial position. (LO6)
The following items were taken from the 30 June consolidated statement of financial position of Field Limited. (All dollars are in millions.)

Inventories	$ 138.9	Other current assets	$ 16.6
Trade and other receivables	182.9	Deferred tax assets (non-current)	57.1
Property, plant and equipment	521.5	Cash and cash equivalents	603.1
Other non-current assets	1.0	Current tax receivable	8.1
Intangible assets	1 410.5	Derivative financial instruments (current)	0.1
Investments in jointly controlled entities (non-current)	6.5	Receivable (non-current)	0.9
Assets held for sale (current)	1.9		

Required
Prepare the assets section of a classified statement of financial position.

Field Limited
Statement of financial position (Partial)
as at 30 June

	$M
Current assets:	
Cash and cash equivalents	603.1
Trade and other receivables	182.9
Inventories	138.9
Derivative financial instruments	0.1
Current tax receivable	8.1
Other current assets	16.6
Assets held for sale	1.9
Total current assets	951.6
Non-current assets	
Receivables	0.9
Investments in jointly controlled entities	6.5
Property, plant and equipment	521.5
Deferred tax assets	57.1
Intangible assets	1410.5
Other non-current assets	1.0
Total non-current assets	1997.5
Total assets	$2949.1

E1.9 Prepare financial statements. (LO6)
These financial statement items are for Wellington Wall Coverings Pty Ltd at year-end, 31 July.

Cost of sales	$ 60 000
Salaries expense	40 000
Other expenses	38 000
Building	140 000
Accounts payable	11 000
Sales revenue	100 000
Rent revenue	50 000
Rent revenue received in advance	2 000
Share capital	160 000
Cash	25 000
Bank loan	110 000
Accumulated depreciation	14 000
Land	120 000
Depreciation expense	7 000
Retained earnings (beginning of the year)	3 000
Inventory	20 000

Required
(a) Prepare a statement of profit or loss for the year.
(b) Prepare a classified statement of financial position at 31 July.

(a)

Wellington Wall Coverings **Pty Ltd**
Statement of profit or loss
for the year ended 31 July

	$	$
Revenues:		
Sales revenue		100,000
Less: Cost of sales		60,000
Gross profit		40,000
Other revenue		
Rent revenue		50,000
Expenses:		
Salaries expense	40,000	
Depreciation expense	7,000	
Other expenses	38,000	
Total expense		(85,000)
Profit		$5,000

Calculation of retained earnings
for the year ended 31 July

	$
Retained earnings, 1 August	3,000
Add: Profit	5,000
Retained earnings, 31 July	$8,000

(b)

Wellington Wall Coverings Pty Ltd
Statement of financial position
as at 31 July

		$	$
Current assets:			
Cash			25,000
Inventory			20,000
Total current assets			45,000
Non-current assets:			
Land		120 000	
Building	140,000		
Less: Accumulated depreciation	(14,000)	126,000	
Total non-current assets			246,000
Total Assets			291,000
Current liabilities:			
Accounts payable		11,000	
Rent received in advance		2,000	
Total current liabilities		13,000	
Non-current liabilities			
Bank loan	110 000		
Total non-current liabilities		110,000	
Total liabilities			123 000
Net Assets			$168 000
Equity			
Share capital			160,000
Retained earnings			8,000
Total equity			$168,000

E1.10 Identify financial statement components and calculate profit. (LO6)
These financial statement items are for Bear Pty Ltd at year-end, 30 June.

Cost of sales	$ 84 000
Salaries expense	56 000
Other expenses	53 200
Building	196 000
Accounts payable	15 400
Sales revenue	140 000
Rent revenue	70 000
Rent revenue received in advance	2 800
Share capital	224 000
Cash	35 000
Bank loan	154 000
Accumulated depreciation	19 600
Land	168 000
Depreciation expense	9 800
Retained earnings (beginning of the year)	4 200
Inventory	28 000

Required
(a) Prepare a statement of profit or loss for the year.
(b) Prepare a calculation of retained earnings for the year.
(c) Prepare a classified statement of financial position at 30 June.

(a)

Bear Pty Ltd
Statement of profit or loss
for the year ended 31 July

	$	$
Revenues:		
Sales revenue		140,000
Less: Cost of sales		84,000
Gross profit		56,000
Other revenue		
Rent revenue		70,000
Expenses:		
Salaries expense	56,000	
Depreciation expense	9,800	
Other expenses	53,200	
Total expense		119,000
Profit		$ 7,000

(b)

Bear Pty Ltd
Calculation of retained earnings
for the year ended 30 June

	$
Retained earnings, 1 July	4,200

Add: Profit	7,000
Retained earnings, 30 June	$11,200

(c)

Bear Pty Ltd
Statement of financial position
as at 30 June

	$	$	$
Current assets:			
Cash			35,000
Inventory			28,000
Total current assets			63,000
Non-current assets:			
Land		168,000	
Building	196,000		
Less: Accumulated depreciation	(19,600)	176,400	
Total non-current assets			344,400
Total Assets			407,400
Current liabilities:			
Accounts payable	15,400		
Rent received in advance	2,800		
Total current liabilities		18,000	
Non-current liabilities			
Bank loan	154,000		
Total non-current liabilities		154,000	
Total liabilities			172,200
Net Assets			$235,200
Equity			
Share capital		224,000	
Retained earnings		11,200	
Total equity			$235,200

E1.11 Calculate liquidity ratios and compare results. (LO9)
Retail Ltd operates stores in numerous states. Selected financial statement data (in thousands of dollars) for the year ended 30 June are as follows.

	End of year	Beginning of year
Cash	$ 8 995	$ 17 807
Receivables (net)	10 711	15 992
Merchandise inventory	184 872	187 890
Other current assets	3 848	1 624
Total current assets	$208 426	$223 313
Total current liabilities	$129 941	$169 549

For the year, net sales revenue was $1 109 934 and cost of sales was $628 197 (in thousands).
Required
(a) Calculate the working capital and current ratio at the beginning of the year and at the end of the current year.
(b) Did Retail Ltd's liquidity improve or worsen during the year?

Retail Ltd

(a) Working capital = current assets – current liabilities

Beginning of year
$53,764,000 = $223,313,000 – $169,549,000

End of year:
$78,485,000 = $208,426,000 – $129,941,000

Current ratio = current assets/current liabilities

Beginning of year:
1.32:1 = $223,313,000 / $169,549,000

End of year:
1.60:1 = $208,426,000 / $129,941,000

(b) These measures indicate that Retail Ltd's liquidity improved during the year.

E1.12 Calculate and interpret solvency ratios. (LO9)
The following data were taken from the 2027 financial statements of Energy Limited. (All dollars in millions.)

	2022	2021
Current assets	$ 2 838.0	$ 4 231.9
Total assets	13 367.8	15 738.4
Current liabilities	2 291.8	7 609.8
Total liabilities	9 026.8	8 605.5
Total equity	8 339.0	8 132.9
Cash provided by operating activities	621.8	467.5
Cash generated by (used in) investing activities	(559.6)	(532.3)

Required
Perform each of the following.
(a) Calculate the debt to assets ratio for each year.
(b) Calculate the cash debt coverage for each year. (Note: Total liabilities at year-end 2020 were $7804 million.)
(c) Discuss Energy Limited's solvency in 2027 versus 2026.
(d) Discuss Energy Limited's ability to finance its investment activities with cash provided by operating activities, and how any deficiency would be met.

Energy Limited

	2027 $ M				2026 $ M			
(a) Debt to assets ratio	$9026.8 / $13367.8	=	0.6753	or 67.53 %	$8605.5 / $15738.4	=	0.5468	or 54.68 %
(b) Cash debt coverage ratio	$621.8 / (($9027 + $8606) / 2)	=	0.070		$467.5 / (($8606 + $7804) / 2)	=	0.057	

(c) The ratio of debt to total assets decreased, indicating decreased reliance on debt, and, Energy Ltd's cash flows from operating activities increased and the coverage of total liabilities increased marginally.

(d) In 2027 Energy's cash provided by operations ($621.8.0M) was sufficient to cover the cash used in investing activities ($559.6M). In 2026 as the net investing activities ($532.3M) was more than the cash generated from operating activities, there was a cash deficiency. Energy Limited, being a publicly listed company, could raise more money from the public through the issue of shares or borrow funds.

E1.13 Calculate and interpret solvency ratios. (LO9)
The following data were taken from the 2027 financial statements of Oldfield Limited. (All dollars in millions.)

	2022	2021
Current assets	$ 726.4	$ 719.8
Total assets	2 756.8	2 694.8
Current liabilities	392.8	534.1
Total liabilities	1 324.5	1 328.7
Total equity	1 652.3	1 376.1
Cash provided by operating activities	188.7	130.0
Cash generated by (used in) investing activities	158.9	(85.6)

Required
Perform each of the following.
(a) Calculate the debt to assets ratio for each year.
(b) Calculate the cash debt coverage for each year. (Note: Total liabilities at year-end 2025 were $1405 million.)
(c) Discuss Oldfield Limited's solvency in 2027 versus 2026.
(d) Discuss Oldfield Limited's ability to finance its investment activities with cash provided by operating activities, and how any deficiency would be met.

Oldfield Limited

	2027 $ M					2026 $ M				
(a) Debt to assets ratio	$1324.5 / 2756.8	=	0.4804	or	48.04 %	$1328.7 / $2694.8	=	0.4931	or	49.31 %
(b) Cash debt coverage ratio	$188.7 / (($1325 + $1329) / 2)	=	0.142			$130 / (($1329 + $1405) / 2)	=	0.095		

(c) The ratio of debt to total assets decreased from 49% to 48%, indicating a slight decrease in the reliance on debt. The net cash flows from operations increased and the cash coverage of total liabilities increased, indicating a better solvency position.

(d) The cash flows from operating activities in both years is greater than required for investing activities in both years.

Solutions to Problem Set A

PSA1.1 Determine forms of business organisation. (LO3)
Presented below are five independent situations.

(a) **Three information systems lecturers have formed a business to improve the speed of information transfer over the internet for securities exchange transactions. Each has contributed an equal amount of cash and knowledge to the venture. Although their approach looks promising, they are concerned about the legal liabilities that their business might confront.**

(b) **Sarah and Andrew wish to purchase a taxi licence. One has a suitable motor vehicle and the other has enough cash to buy the licence.**

(c) **Robert Steven and Tom Cheng each owned separate shoe manufacturing businesses. They have decided to combine their businesses. They expect that within the coming year they will need significant funds to expand their operations.**

(d) **Darcy Becker, Ellen Sweet and Meg Dwyer recently graduated with marketing degrees. They have been friends since childhood.**
They have decided to start a consulting business focused on marketing sporting goods over the internet.

(e) **Anthony Troy wants to rent CD players and CDs in airports across the country. His idea is that customers will be able to rent equipment and CDs at one airport, listen to the CDs on their flights, and return the equipment and CDs at their destination airport. Of course, this will require a substantial investment in equipment and CDs, as well as employees and locations in each airport. Anthony has no savings or personal assets. He wants to maintain control over the business.**

Required
In each case explain what form of organisation the business is likely to take — sole proprietorship, partnership or company. Give reasons for your choice.

(a) The concern over legal liability would make the limited liability company form a better choice over a partnership. Also, the corporate form will allow the business to raise cash more easily which may be of importance in a rapidly growing industry.

(b) Sarah and Andrew should adopt the partnership form because it facilitates bringing together the contribution of skills and resources. Also, there does not appear to be any expected needs for further fund in the near future.

(c) The fact that the combined business expects that it will need to raise significant funds in the near future makes the company form more desirable in this case.

(d) It is likely that this business would form as a partnership. Its needs for additional funds would probably be minimal in the foreseeable future. Also, the three know each other well and would appear to be contributing equally to the firm. Service firms, like consulting businesses, are frequently formed as partnerships.
Alternatively, they may prefer the company form to simplify subsequent expansion and take advantage of limited liability, but they would need to consider the additional regulation that it would involve.

(e) One way to ensure control would be for Anthony to form a sole proprietorship. However, in order for this business to thrive, it will need a substantial investment of funds early. This would suggest the company form of business. In order for Anthony to maintain control over the business, he would need to own more than 50 percent of the voting power. In order for the business to grow, he may have to be willing to give up some control.

PSA1.2 Identify users and uses of financial statements. (LO5)

Financial decisions often place heavier emphasis on one type of financial statement over the others. Consider each of the following hypothetical situations independently.

(a) **North Sales Ltd is considering extending credit to a new customer. The terms of the credit would require the customer to pay within 30 days of receipt of goods.**

(b) **An investor is considering purchasing shares in Giorgina's. The investor plans to hold the investment for at least 5 years.**

(c) **Otago Bank is considering extending a loan to a small company. The company would be required to make interest payments at the end of each year for 5 years, and to repay the loan at the end of the fifth year.**

(d) **The finance director of Pacific Pipes Ltd is trying to determine whether the company is generating enough cash to increase the amount of dividends paid to investors in this and future years, and still have enough cash to buy plant and machinery as needed.**

Required

Although the decision makers should refer to all financial statements, for each situation, state whether the decision maker would be most likely to place the main emphasis on information provided by the statement of profit or loss, statement of financial position or statement of cash flows. In each case provide a brief justification for your choice. Choose only one financial statement in each case.

(a) In deciding whether to extend credit for 30 days you would be most interested in the Statement of financial position because it shows the assets on hand that would be available for settlement of the debt in the near-term.

(b) In purchasing an investment that will be held for an extended period, the investor must try to predict the future performance of Giorgina's. The statement of profit or loss provides the most useful information for predicting future performance.

(c) In extending a loan for a relatively long period of time, the bank is most interested in the probability that the company will generate sufficient income to meet its interest payments and repay its principal. The bank would therefore be interested in predicting future profit using the statement of profit or loss.
It should be noted, however, that the lender would also be very interested in both the Statement of financial position and the Statement of cash flows — the Statement of financial position would show the amount of debt the company has already incurred, as well as assets that could be liquidated to repay the loan. And the bank would be interested in the Statement of cash flows because it would provide useful information for predicting the company's ability to generate cash to repay its obligations.

(d) The finance director would be most interested in the Statement of cash flows since it shows how much cash the company generates and how that cash is used. The Statement of cash flows can be used to predict the company's future cash-generating ability.

PSA1.3 Comment on proper accounting treatment and prepare a corrected statement of financial position. (LO6, 8)
Ultimo Travel Goods Pty Ltd was formed on 1 July 2026. At 30 June 2027, Mark Austin, the managing director and major shareholder, decided to prepare a statement of financial position, which appeared as follows.

ULTIMO TRAVEL GOODS PTY LTD Statement of financial position as at 30 June 2027			
ASSETS		LIABILITIES AND EQUITY	
Cash	$ 20 000	Accounts payable	$ 40 000
Accounts receivable	55 000	Notes payable	15 000
Inventory	30 000	Bank loan	160 000
Villa	300 000	Equity	55 000

Mark willingly admits that he is not an accountant by training. He is concerned that his statement of financial position might not be correct. He has provided you with the following additional information:

1. **The villa is on the Gold Coast and actually belongs to Mark, not to Ultimo Travel Goods Pty Ltd. However, because he thinks he might allow executives to use it sometimes, he decided to list it as an asset of the company. To be consistent he also listed as a liability of the company his personal loan that he took out at the bank to buy the villa.**
2. **The inventory was originally purchased for $10 000, but due to a surge in demand Mark now thinks he could sell it for $30 000. He thought it would be best to record it at $30 000.**
3. **Included in the accounts payable balance is $5000 that Mark owes for his personal telephone account. Mark included this in the accounts payable of Ultimo Travel Goods Pty Ltd because he will probably use company funds to pay for it.**

Required

(a) Comment on the proper accounting treatment of the three items above.

(b) Provide a corrected statement of financial position for Ultimo Travel Goods Pty Ltd. (*Hint*: To get the statement of financial position to balance, adjust equity.)

Ultimo Travel Goods Pty Ltd

(a) 1. The accounting entity concept states that economic events can be identified with a particular unit of accountability. Since the Gold Coast villa is the personal property of Mark Austin — not Ultimo Travel Goods Pty Ltd — it should not be reported on the company's Statement of financial position. Likewise, the loan is a personal loan of Mark Austin — not a liability of the company.

2. The historical cost principle dictates that assets are recorded at their original cost. Therefore, reporting the inventory at $30,000 would be improper and violates the cost principle. The inventory should be reported at $10,000.

3. Including the personal telephone account payable is a violation of the accounting entity concept. The $5,000 payable is not a liability of Ultimo Travel Goods Pty Ltd. If the company pays the telephone account on behalf of Mark Austin, it

should be accounted for as a loan to Mark.

(b)

Ultimo Travel Goods Pty Ltd
Statement of financial position
as at 30 June 2027

	$	$
Assets		
Cash		20 000
Accounts receivable		55 000
Inventory		10 000
Total assets		85,000
Liabilities		
Accounts payable ($40,000 – $5,000)	35,000	
Notes payable	15,000	
Total liabilities		50,000
Net Assets		$35,000
Equity		35,000
Total equity		$35,000

PSA1.4 Prepare financial statements. (LO6)
CSI Pty Ltd was started on 1 October with an investment of $45 000 cash. Following are the assets and liabilities of the company on 31 October, and the revenues and expenses for the month of October, its first month of operations.

Cash	$ 7 800	Bank loan	$30 000
Accounts receivable	11 400	Rent expense	1 500
Equipment	60 000	Repair expense	500
Service revenue	10 000	Fuel expense	3 400
Advertising expense	900	Insurance expense	400
Accounts payable	2 400		

No further shares were issued in October, but a dividend of $1500 in cash was paid.
Required
Prepare a statement of profit or loss and a calculation of retained earnings for the month of October, and prepare a statement of financial position as at 31 October.

CSI Pty Ltd
Statement of profit or loss
for the month ended 31 October

	$	$
Revenues:		
Service revenue		10,000
Expenses:		
Advertising expense	900	
Fuel expense	3,400	
Insurance expense	400	
Rent expense	1,500	
Repair expense	500	
Total expenses		6,700
Profit		$3,300

CSI Pty Ltd
Calculation of retained earnings
for the month ended 31 October

	$
Retained earnings, 1 October	0
Add: Profit	3,300
	3,300
Less: Dividends	(1,500)
Retained earnings, 31 October	$1,800

CSI Pty Ltd
Statement of financial position
as at 31 October

	$	$
Assets:		
Current assets		
Cash		7,800
Accounts receivable		11,400
		19,200
Non-current assets		
Equipment		60,000
Total assets		79,200
Liabilities:		
Current liabilities		
Accounts payable	2,400	
Non-current liabilities		
Bank loan	30,000	
Total liabilities		32,400
Net Assets		$46,800
Equity:		
Share capital	45,000	
Retained earnings	1,800	
Total equity		$46,800

PSA1.5 Determine items included in a statement of cash flows and prepare the statement. (LO6)
Presented below are selected financial statement items for Daisy Ltd for 31 December.

Inventory	$ 32 000
Cash paid to suppliers	195 000
Building	400 000
Share capital	20 000
Share issued for cash this current year	10 000
Cash dividends paid	15 000
Cash paid to purchase equipment	35 000
Equipment	40 000
Revenues	300 000
Cash received from customers	264 000

Required
Determine which items should be included in a statement of cash flows, and then prepare the statement for Daisy Ltd.

Daisy Ltd

Daisy Ltd should include the following items in its Statement of cash flows:

Cash paid to suppliers
Cash dividends paid
Cash paid to purchase equipment
Cash received from customers
Cash received from share issue

Daisy Ltd
Statement of cash flows
for the year ended 31 December

Cash flows from operating activities:	
Cash received from customers	$264,000
Cash paid to suppliers	(195,000)
Net cash provided by operating activities	69,000
Cash flows from investing activities:	
Cash paid to purchase equipment	(35,000)
Net cash used in investing activities	(35,000)
Cash flows from financing activities:	
Cash received issue of shares	10,000
Dividends paid	(15,000)
Net cash used in financing activities	(5,000)
Net increase in cash	$29,000

PSA1.6 Prepare financial statements. (LO6)
Ultra Pty Ltd was started on 1 May with an investment of $75 000 cash. Following are the assets and liabilities of the company on 31 May, and the revenues and expenses for the month of May, its first month of operations.

Cash	$30 500	Bank loan	$40 000
Accounts receivable	25 400	Rent expense	12 500
Equipment	87 000	Repair expense	1 800
Service revenue	42 800	Fuel expense	3 600
Advertising expense	800	Insurance expense	2 600
Accounts payable	8 400		

No further shares were issued in May, but a dividend of $2000 in cash was paid.
Required
Prepare a statement of profit or loss and statement of changes in equity for the month of May, and prepare a statement of financial position as at 31 May.

Ultra Pty Ltd
Statement of profit or loss
for the month ended 31 May

	$	$
Revenues:		
Service revenue		42 800
Expenses:		
Advertising expense	800	
Fuel expense	3 600	
Insurance expense	2 600	
Rent expense	12 500	
Repair expense	1 800	
Total expenses		21 300
Profit		$21 500

Ultra Pty Ltd
Calculation of retained earnings
for the month ended 31 May

	$
Retained earnings, 1 May	0
Add: Profit	21 500
	21 500
Less: Dividends	(2 000)
Retained earnings, 31 May	$19 500

Ultra Pty Ltd
Statement of financial position
as at 31 May

	$	$
Assets:		
Current assets		
Cash		30 500
Accounts receivable		25 400
		55 900
Non-current assets		
Equipment		87 000
Total assets		142 900
Liabilities:		
Current liabilities		
Accounts payable	8 400	
Non-current liabilities		
Bank loan	40 000	
Total liabilities		48 400
Net Assets		$94 500
Equity:		
Share capital	75 000	
Retained earnings	19 500	
Total equity		$94 500

PSA1.7 Determine items included in a statement of cash flows and prepare the statement. (LO6)
Presented below are selected financial statement items for Pod Ltd for 30 June.

Inventory	$ 80 000
Cash	203 000
Cash paid to suppliers	170 000
Building	640 000
Share capital	50 000
Cash dividends paid	18 000
Cash paid to purchase equipment	50 000
Equipment	70 000
Revenues	320 000
Cash received from customers	296 000

Required
Determine which items should be included in a statement of cash flows, and then prepare the statement for Pod Ltd.

Pod Ltd

Pod Ltd should include the following items in its Statement of cash flows:

Cash paid to suppliers
Cash dividends paid
Cash paid to purchase equipment
Cash received from customers

Pod Ltd
Statement of cash flows
for the year ended 30 June

Cash flows from operating activities:	
Cash received from customers	$296 000
Cash paid to suppliers	(170 000)
Net cash provided by operating activities	126 000
Cash flows from investing activities:	
Cash paid to purchase equipment	(50 000)
Net cash used in investing activities	(50 000)
Cash flows from financing activities:	
Dividends paid	(18 000)
Net cash used in financing activities	(18 000)
Net increase in cash	$58 000

PSA1.8 Prepare a classified statement of financial position. (LO6)
The following items are taken from the 30 June statement of financial position of Cement Ltd (in millions).

Cash on deposit (short term)	$ 80.6
Issued capital	2 533.8
Property, plant and equipment	3 367.1
Payables (short term)	761.1
Intangible assets	859.9
Non-controlling interests (part of equity)	99.3
Current tax liabilities	29.1
Other non-current assets	58.5
Other current assets	32.8
Investments accounted for using the equity method (non-current assets)	44.6
Deferred tax assets (non-current)	153.7
Other financial assets (current)	21.6
Other financial liabilities (non-current)	35.5
Other long-term financial assets	13.5
Receivables (short term)	877.8
Other financial liabilities (current)	66.1
Receivables due after 30 June 2023	26.8
Retained earnings	588.0
Cash and cash equivalents	249.9
Loans and borrowings	1 639.6
Provisions (short term)	242.1
Inventories (current)	620.0
Payables (long term)	8.4
Reserves	75.4
Loans and borrowings (due before June 2023)	136.9
Deferred tax liabilities (non-current)	58.6
Provisions (long term)	146.5
Inventories (non-current)	13.6

Required
Prepare a statement of financial position, appropriately classified, for Cement Ltd as at 30 June.

Cement Ltd
Balance Sheet
as at 30 June

	$'m
Current assets:	
Cash and cash equivalents	249.9
Cash on deposit	80.6
Receivable	877.8
Inventories	620.0
Other financial assets	21.6
Other current assets	32.8
Total current assets	1882.7
Non-current assets:	
Receivables	26.8
Inventories	13.6
Investments accounted for using equity method	44.6
Other financial assets	13.5
Property, plant and equipment	3367.1
Intangible assets	859.9

Deferred tax asset	153.7
Other non-current assets	58.5
Total non-current assets	4537.7
Total assets	6420.4
Current liabilities:	
Payables	761.1
Loans and borrowings	136.9
Current tax liabilities	29.1
Other financial liabilities	66.1
Provisions	242.1
Total current liabilities	1235.3
Non-current liabilities:	
Payables	8.4
Loans and borrowings	1639.6
Other financial liabilities	35.5
Deferred tax liabilities	58.6
Provisions	146.5
Total non-current liabilities	1888.6
Total liabilities	3123.9
NET ASSETS	$3296.5
Equity:	
Issued Capital	2533.8
Reserves	75.4
Retained earnings	588.0
Total parent entity interest	3197.2
Non-controlling interests	99.3
TOTAL EQUITY	$3296.5

PSA1.9 Calculate liquidity, solvency and profitability ratios. (LO9)
Here are the comparative statements of City Sales Pty Ltd.

CITY SALES PTY LTD Statement of profit or loss for the year ended 30 June (current year)		
	Current year	Prior year
Net sales	$2 200 000	$2 000 000
Cost of sales	1 120 000	996 000
Selling and administrative expense	830 000	824 000
Interest expense	31 000	30 000
Income tax expense	104 000	50 000
Profit	**$ 115 000**	**$ 100 000**

CITY SALES PTY LTD Statement of financial position as at 30 June (current year)		
	Current year	Prior year
ASSETS		
Current assets		
Cash	$ 100 500	$ 60 000
Short-term investments	90 000	50 000
Accounts receivable (net)	139 000	125 000
Inventory	145 000	115 500
Total current assets	474 500	350 500
Property, plant and equipment (net)	540 300	440 300
Total assets	1 014 800	790 800
LIABILITIES		
Current liabilities		
Accounts payable	146 000	65 400
Income taxes payable	104 000	34 600
Total current liabilities	250 000	100 000
Debentures payable	210 000	200 000
Total liabilities	460 000	300 000
Net assets	**$ 554 800**	**$ 490 800**
EQUITY		
Contributed equity	$ 350 000	$ 300 000
Retained earnings	204 800	190 800
Total equity	**$ 554 800**	**$ 490 800**

The cash provided by operating activities for the current year was $260 000.
Required
Calculate these values and ratios for the current year:
(a) Working capital.
(b) Current ratio.
(c) Current cash debt coverage.
(d) Debt to total assets ratio.
(e) Cash debt coverage.
(f) Profit margin.
(g) Return on assets.

City Sales Pty Ltd

(a) Working capital = $474,500 – $250,000 = $224,500

(b) Current ratio $= \dfrac{\$474{,}500}{\$250{,}000} = 1.9:1$

(c) Current cash debt coverage ratio $= \dfrac{\$260{,}000}{\dfrac{[\$250{,}000 + \$100{,}000]}{2}} = 1.5 \text{ times}$

(d) Debt to total assets ratio $= \dfrac{\$460{,}000}{\$1{,}014{,}800} = 0.453:1$ or 45.3%

(e) Cash debt coverage ratio $= \dfrac{\$260{,}000}{\dfrac{[\$460{,}000 + \$300{,}000]}{2}} = 0.7 \text{ times}$

(f) Profit margin ratio $= \dfrac{\$115{,}000}{\$2{,}200{,}000} = 0.052:1$ or 5.2 %

(g) Return on assets ratio =

$$\frac{\$115{,}000}{\left[\dfrac{\$790{,}800 + \$1{,}014{,}800}{2}\right]} = \frac{\$115{,}000}{\$902{,}800} = 0.127:1$$ OR 12.7%

PSA1.10 Calculate ratios and compare liquidity, solvency and profitability for two entities. (LO9)
Selected financial data (in thousands) of two competitors, AKA Ltd and UFO Ltd, are as follows.

	AKA Ltd	UFO Ltd
	Selected statement of profit or loss data for year	
Net sales	$120 000	$100 000
Cost of sales	65 000	51 000
Borrowing costs (interest expense)	10 500	30 000
Income tax expense	14 000	4 000
Profit	16 000	5 000
	Condensed statement of financial position (end of year)	
Current assets	$ 33 000	$ 20 000
Non-current assets	127 000	175 000
Total assets	**$160 000**	**$195 000**
Current liabilities	$ 15 000	$ 10 000
Non-current liabilities	70 000	160 000
Total equity	75 000	25 000
Total liabilities and equity	**$160 000**	**$195 000**
	Beginning-of-year balances	
Total assets	$140 000	$155 000

Required
For each entity, calculate these values and ratios:
(a) Working capital.
(b) Current ratio.
(c) Debt to total assets ratio.
(d) Return on assets.
(e) Profit margin.
(f) Compare the liquidity, solvency and profitability of the two entities.

AKA Ltd and UFO Ltd

	Ratio	AKA	UFO
		(All dollars are in thousands)	
(a)	Working capital	$33,000 – $15,000 = $18,000	$20,000 – $10,000 = $10,000
(b)	Current ratio	2.2:1 ($33,000 ÷ $15,000)	2.0:1 ($20,000 ÷ $10,000)
(c)	Debt to total assets ratio	53.1% [($15,000 + $70,000) ÷ $160,000]	87.2% [($10,000 + $160,000) ÷ $195,000]
(d)	Return on assets	$10.7\% = \dfrac{\$16{,}000}{(\$160{,}000 + \$140{,}000)/2}$	$2.9\% = \dfrac{\$5{,}000}{(\$195{,}000 + \$155{,}000)/2}$
(e)	Profit margin ratio	$13.3\% = \dfrac{\$16{,}000}{\$120{,}000}$	$5.0\% = \dfrac{\$5{,}000}{\$100{,}000}$

(f) The comparison of the two companies shows the following:

Liquidity — AKA's current ratio of 2.2:1 is better than UFO's 2.0:1. AKA also has higher working capital than UFO.

Solvency — AKA's debt to total assets ratio is lower than that of UFO, indicating that AKA has better solvency.

Profitability — AKA has a higher return on assets and profit margin ratio than UFO, indicating that it is more profitable than UFO. Note that UFO's higher borrowing costs, resulting from its greater reliance on debt, has reduced its profitability.

Solutions to Problem Set B

PSB1.1 Determine forms of business organisation. (LO3)
Presented below are five independent situations.

(a) **Fiona has just graduated with a media and communications degree and wants to start an events management business. She has some savings and her family is willing to support her in her endeavours. Although she has had offers to work for several established businesses, Fiona wants to try it on her own and she wants to maintain control over the business.**

(b) **Mark has been operating as a sole trader for a number of years. Profits are slowly increasing and he expects his gross profit before income tax this year to be around $200 000. Mark also has an opportunity to expand operations and will need to borrow larger sums from a bank or similar financial institution.**

(c) **Maurice, Jacob and Emily have all just graduated with commerce degrees, one in accounting, another in IT and the third in marketing. They want to combine their skills and start a business selling goods over the internet.**

(d) **Amanda and Jessica have been friends since school and want to make a go of their hobby of jewellery making. They already have fashion stores interested in stocking their product, plus they have a web site and sell goods over the internet.**

(e) **Michael Murphy and Steve Elks each own separate printing businesses. They have decided to combine their businesses. They expect that within the coming year they will need significant funds to expand their operations.**

Required
In each case explain what form of organisation the business is likely to take — sole proprietorship, partnership or company. Give reasons for your choice.

(a) One way to ensure control would be for Fiona to form a sole proprietorship. However, in order for this business to thrive, it will need a substantial investment of funds early. This would suggest the company form of business. In order for Fiona to maintain control over the business, she would need to own more than 50 percent of the voting power. In order for the business to grow, she may have to be willing to give up some control, maybe her family would also invest or loan the business funds in the early stages of establishment.

(b) Mark should incorporate the business to minimise tax plus he will need to prepare financial forecast to present to the financial institutions to borrow funds. It is likely Mark would not immediately have the advantage of limited liability as the financial institutions would usually require a personal guarantee from Mark for the debt borrowings.

(c) It is likely that this business would form as a partnership. Its needs for additional funds would probably be minimal in the foreseeable future. Also, the three know each other well and would appear to be contributing equally to the business.
Alternatively, they may prefer the company form to simplify subsequent expansion and take advantage of limited liability, but they would need to consider the additional regulation that it would involve.

(d) Amanda and Jessica should adopt the partnership form because it facilitates bringing together the contribution of skills and resources. Also there does not appear to be any expected needs for further fund in the near future.

(e) The fact that the combined business expects that it will need to raise significant funds in the near future makes the company form more desirable in this case.

PSB1.2 Identify users and uses of financial statements. (LO5)
Financial decisions often place heavier emphasis on one type of financial statement over the others. Consider each of the following hypothetical situations independently.

(a) The finance director of Organic Products Ltd is trying to determine whether the company is generating enough cash to buy new equipment for the business without borrowing and still have enough left to pay dividends to investors.
(b) An investor is considering purchasing shares in Woolworths Limited. The investor plans to hold the investment for at least 4 years.
(c) Datt Ltd is considering extending credit to a new customer. The terms of the credit would require the customer to pay within 30 days of receipt of the goods.
(d) Intrigue Finance is considering extending a loan to a company. The company would be required to make interest payments at the end of each year for 8 years, and to repay the loan at the end of the eighth year.

Required
Although the decision makers should refer to all financial statements, for each situation, state whether the decision maker would be most likely to place the main emphasis on information provided by the statement of profit or loss, statement of financial position or statement of cash flows. In each case provide a brief justification for your choice. Choose only one financial statement in each case.

(a) The finance director would be most interested in the Statement of cash flows since it shows how much cash the company generates and how that cash is used. The Statement of cash flows can be used to predict the company's future cash-generating ability.

(b) In purchasing an investment that will be held for an extended period, the investor must try to predict the future performance of Woolworths'. The statement of profit or loss provides the most useful information for predicting future performance.

(c) In deciding whether to extend credit for 30 days you would be most interested in the Statement of financial position because it shows the assets on hand that would be available for settlement of the debt in the near-term.

(d) In extending a loan for a relatively long period of time, the bank is most interested in the probability that the company will generate sufficient income to meet its interest payments and repay its principal. The bank would therefore be interested in predicting future profit using the statement of profit or loss.
It should be noted, however, that the lender would also be very interested in both the Statement of financial position and the Statement of cash flows — the Statement of financial position would show the amount of debt the company has already incurred, as well as assets that could be liquidated to repay the loan. And the bank would be interested in the Statement of cash flows because it would provide useful information for predicting the company's ability to generate cash to repay its obligations.

PSB1.3 Comment on proper accounting treatment and prepare a corrected statement of financial position. (LO6, 8)
Saturn Pty Ltd was formed on 1 July 2026. At 30 June 2027, Mary Eagle, the managing director and major shareholder, decided to prepare a statement of financial position, which appeared as follows.

SATURN PTY LTD Statement of financial position as at 30 June 2027			
ASSETS		LIABILITIES AND EQUITY	
Cash	$ 112 000	Accounts payable	$130 000
Accounts receivable	168 000	Notes payable	60 000
Inventory	150 000	Bank loan	640 000
Villa	1 000 000	Equity	144 000

Mary willingly admits that she is not an accountant by training. She is concerned that her statement of financial position might not be correct. She has provided you with the following additional information.

1. **The villa is in Foster and actually belongs to Mary, not Saturn Pty Ltd. However, because she thinks she might allow executives to use it sometimes, she decided to list it as an asset of the company. To be consistent, she also listed, as a liability of the company, her personal loan that she took out at the bank to buy the villa.**
2. **The inventory was originally purchased for $50 000, but due to a surge in demand Mary now thinks she could sell it for $150 000. She thought it would be best to record it at $150 000.**
3. **Included in the accounts payable balance is $4000 that Mary owes for her personal electricity account. Mary included this in the accounts payable of Saturn Pty Ltd because she will probably use company funds to pay for it.**

Required

(a) Comment on the proper accounting treatment of the three items above.

(b) Provide a corrected statement of financial position for Saturn Pty Ltd.

Saturn Pty Ltd

(a) 1. The accounting entity concept states that economic events can be identified with a particular unit of accountability. Since the Port Macquarie villa is the personal property of Mary Eagle — not Saturn Pty Ltd — it should not be reported on the company's Statement of financial position. Likewise, the loan is a personal loan of Mary Eagle — not a liability of the company.

2. The historical cost principle dictates that assets are recorded at their original cost. Therefore, reporting the inventory at $150,000 would be improper and violates the cost principle. The inventory should be reported at $50,000.

3. Including the personal electricity account payable is a violation of the accounting entity concept. The $4,000 payable is not a liability of Saturn Pty Ltd. If the company pays the electricity account on behalf of Mary Eagle, it should be accounted for as a loan to Mary.

(b)

Saturn Pty Ltd
Statement of financial position
as at 30 June 2027

	$	$
Assets		
Cash		112 000
Accounts receivable		168 000
Inventory		50 000
Total assets		330 000
Liabilities		
Accounts payable ($130,000 – $4,000)	126 000	
Notes payable	60 000	
Total liabilities		186 000
Net Assets		$144 000
Equity		144 000
Total equity		$144 000

PSB1.4 Prepare financial statements. (LO6)
Evans Ltd was started on 1 July 2026 with an investment of $150 000 cash. Following are the assets and liabilities of the company on 30 June 2027, and the revenues and expenses for the year of operations.

Cash	$155 100	Bank loan	$90 000
Accounts receivable	43 000	Rent expense	37 500
Equipment (net)	120 000	Repair expense	700
Service revenue	250 000	Office expense	68 000
Advertising expense	16 500	Depreciation expense	30 000
Accounts payable	24 800	Insurance expense	24 000

No further shares were issued during the year, but a dividend of $20 000 in cash was paid.
Required
Prepare a statement of profit or loss, a calculation of retained earnings for the year, and a statement of financial position as at 30 June 2027.

Evans Ltd
Statement of profit or loss
for the year ended 30 June 2027

	$	$
Revenues:		
Service revenue		250 000
Expenses:		
Advertising expense	16 500	
Depreciation expense	30 000	
Insurance expense	24 000	
Office expense	68 000	
Rent expense	37 500	
Repair expense	700	
Total expenses		176 700
Profit		73 300

Evans Ltd
Calculation of retained earnings
for the year ended 30 June 2027

		$
Retained earnings, 1 July 2026		0
Add:	Profit	73 300
		73 300
Less:	Dividends	(20 000)
Retained earnings, 30 June 2027		$53 300

Evans Ltd
Statement of financial position
as at 30 June 2027

	$	$
Assets:		
Current assets		
Cash		155 100
Accounts receivable		43 000
		198 100
Non-current assets		
Equipment		120 000
Total assets		318 100
Liabilities:		
Current liabilities		
Accounts payable	24 800	
Non-current liabilities		
Bank loan	90 000	
Total liabilities		114 800
Net Assets		$203 300
Equity:		
Share capital	150 000	
Retained earnings	53 300	
Total equity		$203 300

PSB1.5 Determine items included in a statement of cash flows and prepare the statement. (LO6)
Presented below are selected financial statement items for Buzzy Bee Ltd for 31 December.

Inventory	$ 80 000
Cash paid to suppliers	301 500
Building	1 800 000
Share capital	200 000
Cash received—issue of shares	50 000
Cash dividends paid	15 000
Cash paid to purchase equipment	210 000
Equipment	240 000
Revenues	560 000
Cash received from customers	509 200

Required
Determine which items should be included in a statement of cash flows, and then prepare the statement for Buzzy Bee Ltd.

Buzzy Bee Ltd

Buzzy Bee Ltd should include the following items in its Statement of cash flows:

Cash paid to suppliers
Cash dividends paid
Cash paid to purchase equipment
Cash received from customers
Cash received from share issue

Buzzy Bee Ltd
Statement of cash flows
for the year ended 31 December

Cash flows from operating activities:	
Cash received from customers	$509 200
Cash paid to suppliers	(301 500)
Net cash provided by operating activities	207 700
Cash flows from investing activities:	
Cash paid to purchase equipment	(210 000)
Net cash used in investing activities	(210 000)
Cash flows from financing activities:	
Cash from share issue	50 000
Dividends paid	(15 000)
Net cash provided in financing activities	35 000
Net increase in cash	$32 700

PSB1.6 Prepare financial statements. (LO6)

Frankie Ltd was started on 1 May with an investment of $120 000 cash. Following are the assets and liabilities of the company on 31 May, and the revenues and expenses for the month of May, its first month of operation.

Cash	$ 76 700	Bank loan	$80 000
Accounts receivable	29 600	Rent expense	7 600
Equipment	126 000	Repair expense	1 200
Service revenue	60 000	Office expense	16 400
Advertising expense	4 000	Insurance expense	2 400
Accounts payable	5 400		

No further shares were issued in May, but a dividend of $1500 in cash was paid.

Required

Prepare a statement of profit or loss and calculate retained earnings for the month of May and prepare a statement of financial position as at 31 May.

Frankie Ltd
Statement of profit or loss
for the month ended 31 May

	$	$
Revenues:		
Service revenue		60 000
Expenses:		
Advertising expense	4 000	
Office expense	16 400	
Insurance expense	2 400	
Rent expense	7 600	
Repair expense	1 200	
Total expenses		31 600
Profit		$28 400

Frankie Ltd
Calculation of retained earnings
for the month ended 31 May

	$
Retained earnings, 1 May	0
Add: Profit	28 400
	28 400
Less: Dividends	(1 500)
Retained earnings, 31 May	$26 900

Frankie Ltd
Statement of financial position
as at 31 May

	$	$
Assets:		
Current assets		
Cash		76 700
Accounts receivable		29 600
		106 300
Non-current assets		
Equipment		126 000
Total assets		232 300
Liabilities:		
Current liabilities		
Accounts payable	5 400	
Non-current liabilities		
Bank loan	80 000	
Total liabilities		85 400
Net Assets		$146.900
Equity:		
Share capital	120 000	
Retained earnings	26 900	
Total equity		$146.900

PSB1.7 Determine items included in a statement of cash flows and prepare the statement. (LO6)
Presented below are selected financial statement items for Spoon Ltd as at 30 June.

Inventory	$ 65 000
Cash	270 000
Cash paid to suppliers	205 000
Building	640 000
Share capital	50 000
Cash dividends paid	77 000
Cash paid to purchase equipment	105 000
Equipment	140 000
Revenues	605 000
Cash received from customers	515 000

Required
Determine which items should be included in a statement of cash flows, and then prepare the statement for Spoon Ltd.

Spoon Ltd

Spoon Ltd should include the following items in its Statement of cash flows:

Cash paid to suppliers
Cash dividends paid
Cash paid to purchase equipment
Cash received from customers

Spoon Ltd
Statement of cash flows
for the year ended 30 June

Cash flows from operating activities:	
Cash received from customers	$515 000
Cash paid to suppliers	(205 000)
Net cash provided by operating activities	310 000
Cash flows from investing activities:	
Cash paid to purchase equipment	(105 000)
Net cash used in investing activities	(105 000)
Cash flows from financing activities:	
Dividends paid	(77 000)
Net cash used in financing activities	(77 000)
Net increase in cash	$128 000

PSB1.8 Prepare financial statements. (LO6)
An extract from the general ledger of Retail Limited for the year ended 30 June 2027 appears as follows.

Item	$	Item	$
Accounts payable	3 300	Inventory	21 500
Accounts receivable	8 320	Other expenses	6 250
Advertising expense	5 000	Rent expense	2 500
Bank loan	15 000	Repairs expense	15 000
Cash	24 250	Opening retained earnings	12 500
Cost of sales	82 000	Salaries expense	35 000
Equipment	83 000	Sales	167 420
Insurance expense	1 300	Share capital	100 000
Intangibles	6 300	Dividends paid	7 800

Additional information:
- **Cash paid to suppliers $84 500**
- **All other expenses were paid in cash**
- **Cash received from customers $172 350**
- **Cash paid to purchase equipment $36 000**
- **The bank loan was taken out in the current year and is repayable in May 2029.**

Required
(a) Prepare a statement of profit or loss for the year ended 30 June 2027.
(b) Prepare a calculation of retained earnings for the year ended 30 June 2027.
(c) Prepare a statement of financial position as at 30 June 2027.
(d) Prepare a statement of cash flows for the year ended 30 June 2027.
(e) Calculate the cash account balance at 1 July 2026 (i.e. the opening balance).

(a)

Retail Ltd
Statement of profit or loss
for the year ended 30 June 2027

	$	$
Revenues:		
Sales revenue		167 420
Less: Cost of sales		82 000
Gross profit		85 420
Expenses:		
Salaries expense	35 000	
Advertising expense	5 000	
Insurance expense	1 300	
Rent expense	2 500	
Repairs expense	15 000	
Other expenses	6 250	
Total expense		(65 050)
Profit		$20 370

(b)

Retail Ltd
Calculation of retained earnings
for the year ended 31 July 2027

	$
Retained earnings, 1 July 2026	12 500
Add: Profit	20 370
	32 870
Less: Dividend	7 800
Retained earnings, 30 June 2027	$25 070

(c)

Retail Ltd
Statement of financial position
as at 30 June 2027

		$	$
Current assets:			
Cash			24 250
Accounts receivable			8 320
Inventory			21 500
Total current assets			54 070
Non-current assets:			
Equipment		83 000	
Intangibles		6 300	
Total non-current assets			89 300
Total Assets			143 370
Current liabilities:			
Accounts payable	3 300		
Total current liabilities		3 300	
Non-current liabilities			
Bank loan	15 000		
Total non-current liabilities		15 000	
Total liabilities			18 300
Net Assets			$125 070
Equity			
Share capital			100 000
Retained earnings			25 070
Total equity			$125 070

(d)

Retail Ltd
Statement of cash flows
for the year ended 30 June 2027

Cash flows from operating activities:		
Cash received from customers	$172 350	
Cash paid operating expenses	(65 050)	
Cash paid to suppliers	(84 500)	
Net cash provided by operating activities		22 800
Cash flows from investing activities:		
Cash paid to purchase equipment	(36 000)	
Net cash used in investing activities		(36 000)
Cash flows from financing activities:		
Cash from borrowing	15 000	
Dividends paid	(7 800)	
Net cash provided in financing activities		7 200
Net decrease in cash		($6 000)

(e) Calculate the Cash account balance at 1 July 2026 (i.e.) the opening balance).

Opening cash balance = Closing balance + decrease in cash
= $24 250 + $6 000
= $30 350

PSB1.9 Calculate liquidity, solvency and profitability ratios. (LO9)
Here are the comparative statements of Nixon Pty Ltd.

NIXON PTY LTD Statement of profit or loss for the year ended 30 June (current year)		
	Current year	Prior year
Net sales	$3 300 000	$3 000 000
Cost of sales	1 680 000	1 494 000
Selling and administrative expense	1 245 000	1 236 000
Interest expense	46 500	45 000
Income tax expense	156 000	75 000
Profit after tax	**$ 172 500**	**$ 150 000**

NIXON PTY LTD Statement of financial position as at 30 June (current year)		
	Current year	Prior year
ASSETS		
Current assets		
Cash	$ 150 750	$ 90 000
Short-term investments	135 000	75 000
Accounts receivable (net)	208 500	187 500
Inventory	217 500	173 250
Total current assets	711 750	525 750
Property, plant and equipment (net)	810 450	660 450
Total assets	1 522 200	1 186 200
LIABILITIES		
Current liabilities		
Accounts payable	219 000	98 100
Income taxes payable	156 000	51 900
Total current liabilities	375 000	150 000
Debentures payable	315 000	300 000
Total liabilities	690 000	450 000
Net assets	**$ 832 200**	**$ 736 200**
EQUITY		
Contributed equity	$ 525 000	$ 450 000
Retained earnings	307 200	286 200
Total equity	**$ 832 200**	**$ 736 200**

The cash provided by operating activities for the current year was $375 000.
Required
Calculate these values and ratios for the current year:
(a) Working capital.
(b) Current ratio.
(c) Current cash debt coverage.
(d) Debt to total assets ratio.
(e) Cash debt coverage.
(f) Profit margin.
(g) Return on assets.

Nixon Pty Ltd

(a) Working capital = $711 750 – $375 000 = $336 750

(b) Current ratio $= \dfrac{\$711\,750}{\$375\,000} = 1.9:1$

(c) Current cash debt coverage ratio $= \dfrac{\$375\,000}{\dfrac{[\$375\,000 + \$150\,000]}{2}} = 1.43 \text{ times}$

(d) Debt to total assets ratio $= \dfrac{\$690\,000}{\$1\,522\,200} = 0.453:1$ or 45.3%

(e) Cash debt coverage ratio $= \dfrac{\$375\,000}{\dfrac{[\$690\,000 + \$450\,000]}{2}} = 0.66 \text{ times}$

(f) Profit margin ratio $= \dfrac{\$172{,}500}{\$3{,}300{,}000} = 0.052:1$ or 5.2 %

(g) Return on assets ratio =

$$\frac{\$172{,}500}{\left[\dfrac{\$1522200 + \$11862000}{2}\right]} = \frac{\$172\,500}{\$1354200} = 0.127:1 \text{ OR } 12.7\%$$

.

PSB1.10 Calculate ratios and compare liquidity, solvency and profitability for two entities. (LO9)

Selected financial data (in thousands) of two competitors, NEW Ltd and OLD Ltd, are as follows.

	NEW Ltd	OLD Ltd
	Selected statement of profit or loss data for year	
Net sales	$420 000	$350 000
Cost of sales	227 500	178 500
Borrowing costs (interest expense)	36 750	105 000
Income tax expense	49 000	14 000
Profit	56 000	17 500
	Condensed statement of financial position (end of year)	
Current assets	$115 500	$ 70 000
Non-current assets	444 500	612 500
Total assets	**$560 000**	**$682 500**
Current liabilities	$ 52 500	$ 35 000
Non-current liabilities	245 000	560 000
Total equity	262 500	87 500
Total liabilities and equity	**$560 000**	**$682 500**
	Beginning-of-year balances	
Total assets	$490 000	$542 500

Required

For each entity, calculate these values and ratios:

(a) Working capital.

(b) Current ratio.

(c) Debt to total assets ratio.

(d) Return on assets.

(e) Profit margin.

(f) Compare the liquidity, solvency and profitability of the two entities.

NEW Ltd and OLD Ltd

	Ratio	NEW Ltd	OLD ltd
		(All dollars are in thousands)	
(a)	Working capital	\$115 500 – \$52 500 = \$63 000	\$70 000 – \$35 000 = \$35 000
(b)	Current ratio	2.2:1 (\$115 500 ÷ \$52 500)	2.0:1 (\$70 000 ÷ \$35 000)
(c)	Debt to total assets ratio	53.1% [(\$52 500 + \$245 000) ÷ \$560 000]	87.2% [(\$35 000 + \$560 000) ÷ \$682 500]
(d)	Return on assets	$10.7\% = \dfrac{\$56000}{(\$560000+\$490000)/2}$	$2.9\% = \dfrac{\$17500}{(\$682500+\$542500)/2}$
(e)	Profit margin ratio	$13.3\% = \dfrac{\$56000}{\$420000}$	$5.0\% = \dfrac{\$17500}{\$350000}$

(f) The comparison of the two companies shows the following:

Liquidity — NEW's current ratio of 2.2:1 is better than OLD's 2.0:1. NEW also has higher working capital than OLD.

Solvency — NEW's debt to total assets ratio is lower than that of OLD, indicating that NEW has better solvency.

Profitability — NEW has a higher return on assets and profit margin ratio than OLD, indicating that it is more profitable than OLD. Note that OLD's higher borrowing costs, resulting from its greater reliance on debt, has reduced its profitability.

Building business skills

Financial reporting and analysis

BBS1.1

Financial reporting problem: Giorgina's Pizza Enterprises Ltd
Giorgina's 2026 financial statements were provided earlier in this chapter in figures 1.14, 1.16 and 1.17.
Required
Use Giorgina's financial data to answer these questions:

(a) What were Giorgina's total assets at 30 June 2026? 1 July 2025?
(b) How much inventory did Giorgina's have on 30 June 2026?
(c) What amount of accounts payable (payables) did Giorgina's report on 30 June 2026? on 1 July 2025?
(d) What were Giorgina's sales in 2026? in 2025?
(e) What is the amount of the change in profit before tax from 2025 to 2026?
(f) The accounting equation is: Assets = Liabilities + Equity. Replacing the words in that equation with dollar amounts, give Giorgina's accounting equation at 30 June 2026.
(g) What were the current liabilities on 1 July 2025?

(a) Giorgina's total assets at 30 June 2026 were $142,312,000 and at 1 July 2025 were $131,491,000

(b) Giorgina's had $5,014,000 of inventory at 30 June 2026.

(c) Giorgina's had Trade and other payables totalling $28,541,000 at 30 June 2026 and $25,629,000 on 1 July 2025.

(d) Giorgina's reported sales in 2026 of $141,473,000 and in 2025 of $126,350,000.

(e) Giorgina's profit before tax decreased by $1,656,000 from 2025 to 2026, from $32,228,000 to $30,572,000.

(f) Giorgina's accounting equation is:

Assets	=	Liabilities	+	Equity
$142,312.00		$65,378.00		$76,934.00

(g) Giorgina's has current liabilities of $38,708,000 at 1 July 2025.

BBS1.2

Comparative analysis problem: Giorgina's Pizza Enterprises Ltd
Extracts from the 2026 financial statements of Classic Food Ltd (a hypothetical company) are presented below, and Giorgina's 2026 financial statements are in figures 1.14, 1.16 and 1.17.

CLASSIC FOOD LTD
Statement of profit or loss (extract)
for the year ended 30 June 2026

	2026 $'000	2025 $'000
Revenue	650 738	237 735
Borrowing costs expense	(4 463)	(574)
Profit from ordinary activities before income tax expense	37 265	19 330
Income tax expense	(13 713)	(7 078)
Profit from ordinary activities after income tax expense	23 552	12 252

CLASSIC FOOD LTD
Statement of financial position
as at 30 June 2026

	2026 $'000	2025 $'000
ASSETS		
Current assets		
Cash	25 000	5 220
Receivables	7 842	4 112
Inventories	139 412	70 055
Other	2 446	1 951
Total current assets	174 700	81 338
Non-current assets		
Property, plant and equipment	86 158	40 729
Deferred tax assets	6 900	3 205
Intangible assets	96 085	44 530
Other	384	494
Total non-current assets	189 527	88 958
Total assets	364 227	170 296
LIABILITIES		
Current liabilities		
Payables	139 500	60 797
Interest-bearing liabilities	35 016	17 895
Current tax liabilities	6 743	5 623
Provisions	13 741	8 522
Total current liabilities	195 000	92 837
Non-current liabilities		
Interest-bearing liabilities	60 891	31 634
Deferred tax liabilities	1 712	1 421
Provisions	6 917	5 105
Total non-current liabilities	69 520	38 160
Total liabilities	264 520	130 997
Net assets	**99 707**	**39 299**
EQUITY		
Contributed equity	77 663	31 442
Retained earnings	22 044	7 857
Total equity	**99 707**	**39 299**

Required

(a) **For each entity calculate the return on assets and profit margin.**
(b) **Which entity appears to have stronger profitability?**
(c) **For each entity calculate working capital and the current ratio.**
(d) **Which entity appears to have stronger liquidity?**
(e) **What additional information would you require to make a better decision about the future profitability and liquidity of the two companies?**

Giorgina's Pizza Enterprises Ltd vs. Classic Food Ltd

(a)

(Amounts in thousands)	**Giorgina's Pizza Enterprises Ltd**	**Classic Food Ltd**
1. Return on Total assets	$21,400/ [($142,312+$131,491)/2] = **15.63%**	$23,552/[($364,227+$170,296)/2] = **8.8%**
2. Profit Margin Ratio*	$21,400 / $141,473 = **15.12%**	$23,552 / $650,738 = **3.6%**

* Sales Revenue from the statement of profit or loss was used here for the profit margin.

(b) The ratios indicate that Giorgina's has a stronger profitability because both its return on total assets and profit margin ratio are greater than those of Classic's. Overall Giorgina's is a stronger performer although Classic is a larger entity.

(c)

Working capital	$6,807 ($45,286 – $38,479)	–$20,300 ($174,700 – $195,000)
Current ratio	**1.177:1** ($45,286 / $38,479)	**0.90:1** ($174,700 / $195,000)

(d) Giorgina's appears to have better liquidity because it has a higher current ratio and more working capital. Classic Food has negative working capital.

(e) In order to make an informed assessment of the two companies' performances you would require industry information as a benchmark. You would also need as full set of accounts including the notes to the accounts. Classic Food has doubled in size during last twelve months. So details of any acquisitions and new share issues. Information about the companies from their web pages or media releases

BBS1.3

Interpreting financial statements
Tick Tock Technology Ltd launched its latest wireless communications product in the current year. The company spent much of the prior year developing and testing software so that its equipment could operate seamlessly in the public switched telephone network. Information from the company's statement of cash flows for the year ended 31 December follows.

	Current year	Prior year
Cash received from customers	—	—
Cash generated (used) by operating activities	$(8 700 703)	$(11 265 540)
Cash generated (used) by investing activities	183 160	(42 968)
Cash provided (used) by financing activities	8 489 104	11 226 587
Net change in cash	**$ (28 439)**	**$ (81 921)**

The most significant source of cash generation was borrowing in the prior year and share issues in the current year. Despite delays, management has expressed confidence that the company is now positioned with a considerable competitive advantage.
Required
Use the information provided to answer each of the following.
(a) If you were a creditor of Tick Tock Technology, what reaction might you have to the current year and prior year statements of cash flows?
(b) If you were a shareholder of Tick Tock Technology, what reaction might you have to the cash flows in the current year?
(c) If you were evaluating the company as either a creditor or a shareholder, what other information would you be interested in reviewing?

Tick Tock Technology Ltd

(a) Creditors lend money to companies with the expectation that they will be repaid at a specified point in time in the future. During current year and the prior year Tick Tock Technology' operating activities used cash instead of generating it, which is not uncommon in start-up companies in this industry. The company has been reliant on borrowing and contributions from shareholders to meet its investing cash needs and provide cash for operations. Creditors may also be concerned about reduced cash holdings which occurred in both years. Creditors may be reluctant to lend to the company without having some additional assurance of repayment. Although details were not provided in the question as to when the company was to generate cash inflows from operating activities it was disclosed that Tick Tock Technology had not received any cash from customers in the current year or the prior year.

(b) Shareholders are interested in the long-term performance of a company and how that translates into its share price. Shareholders may be concerned that the company's operations have continued to drain cash flows in the current year. However, this may be reasonably expected during the start-up phase of a communications company. There was a new share issue during the current year so investor/shareholders must believe in the future viability of the technology the company is developing.

(c) More detailed information about the components of operating, financing and investing cash flows would be useful to determine how cash is being used and in particular, why investing cash flows were a net inflow in the current year. The Statement of cash flows reports information on a cash basis. An investor cannot get the complete story without looking at the statement of profit or loss and statement of financial position as well. A copy of the prospectus used to raise the capital would provide useful information about the elected future cash flows of Tick Tock Technology.

BBS1.4

Financial analysis on the web
Purpose: This exercise is an introduction to some large accounting firms.
Addresses: Deloitte www.deloitte.com/au and www.deloitte.com/nz
Ernst & Young www.ey.com/au/en/home
KPMG www.kpmg.com.au
PricewaterhouseCoopers www.pwc.com.au or www.pwc.co.nz
Steps: Go to the homepage of a firm that is of interest to you.
Required
Answer the following questions.
(a) Name two services provided by the firm.
(b) What countries or regions does it operate in?
(c) Does it provide information for students? If so, briefly describe the type of information.
(d) Summarise one recent news item discussed on the firm's web site.

Answers to this question will differ over time and depending on the accounting forms chosen by the student, choice of services (part b) and choices of news item (part d). We provide the following solution for Deloitte as at September 2025.

(a) Deloitte Australia:

Audit

Assurance

Business Process Solutions

Customer

Cyber

Deloitte Private

Economics

Engineering, AI & Data

Enterprise Technology & Performance

Global Employer Services

Human Capital

Strategy & Transactions

Sustainability

International Specialist Services

Legal

Operate

Risk, Regulatory & Forensic

Strategy & Transactions

Tax

(b) Deloitte operates in over 150 locations around the world including Albania, Argentina, Armenia, Algeria, Australia, Austria, Bahamas, Bahrain, Belarus, Belgium, Brazil, Bermuda, Brunei Darussalam, Bulgaria, Canada, Cayman Islands, Chile, China, Costa Rica, Croatia, Curacao, Cyprus, Czech Republic, Denmark, Dominican Republic, Ecuador, Egypt, Ethiopia, Finland, France, Germany, Gibraltar, Greece, Guatemala, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Japan, Jordan, Korea, Kuwait, Latvia, Lebanon, Lithuania, Luxembourg, Malaysia, Malta, Moldova, Morocco, Mozambique, Netherlands, New Zealand, Nigeria, Norway, Oman, Pakistan, Papua New Guinea, Philippines, Poland, Qatar, Romania, Russia, Saudi Arabia, Serbia, Singapore, Slovak Republic, Slovenia, South Africa, Sweden, Syria, Taiwan, Thailand, Turkey, United Kingdom, United States, Uruguay, Vietnam, Yemen.

(c) <u>Australia:</u> Careers information and student programs.
Deloitte run a graduate program for new university graduates but also operate student programs (listed below). The advantage of the student programs is that ‘those who participate in our student programs often secure a Deloitte graduate position well before their peers.’
The student programs are:
Summer Vacation Program: spend three to eight weeks of paid internship, in one of the business units, with the prospect of obtaining a graduate position. The Summer Vacation Program is open for students in their penultimate (second last) year of study.
Graduate Program: provides the tools and training to ensure ‘graduates can achieve success through mentoring, peer support and e-learning’.

(d) <u>Australia:</u> June 2025:
“AI can help avoid approximately US$70 billion annually in direct natural disaster costs by 2050: Deloitte Global report”
New analysis reveals AI's transformative potential to enhance infrastructure planning, response, and recovery, offering a strategic path to minimizing future natural disaster costs.

Critical thinking

BBS1.5

Group decision case

Permanent Press provides laundry services to hotels and hospitals. In a recent annual report, Permanent Press chronicled its contributions to community services over the past 10 years. The following excerpts illustrate the variety of services provided.

1. **At a local festival, Permanent Press sponsored the event by providing T-shirts, stationery and office decorations featuring the company's name and logo.**

2. **In support of the 'Clean Up Australia' campaign in 2026, the company donated, and its employees planted, grevillea gardens in cities across Australia.**

3. **The company held a competition in which customers throughout Australia and New Zealand nominated their favourite children's charities. Winning charities in the draw received a monetary donation from Permanent Press in the name of the customer.**

4. **Permanent Press executives often volunteer their time and resources to serve as role models and mentors to young people in Auckland.**

Required

With the class divided into groups, answer the following.

(a) **The entity assumption requires that a company keep the personal expenses of its employees separate from business expenses. Which of the activities listed above were expenses of the business, and which were personal expenses of the employees? Be specific. If part of the donation is business and part is personal, note which part is each.**

(b) **For those items that were business expenses, state whether the expense was probably categorised as an advertising expense, employee wages expense, grounds maintenance expense, or charitable contribution expense. You may use any or all of the categories. Explain your answer.**

Permanent Press

(a) (1) This is an expense of the business because Permanent Press has provided its stationery, T-shirts and office decorations.

(2) The donation of the grevilleas was an expense of the business; the planting of the gardens was likely on the employees' own time and therefore a personal donation of time by the employees. If Permanent Press paid wages and salaries to its personnel for planting the gladiolas, that would be an expense of Permanent Press.

(3) This is a business expense since the payment is made by Permanent Press to the charity.

(4) As the executives are volunteering their own time, this is not an expense of Permanent Press. It is a personal cost to the executives.

(b) (1) Advertising expense is the most likely category of those listed because the name, Permanent Press, and the company logo were on all the gifts.

(2) Charitable contribution expense is the most likely account. It is **not** Grounds Maintenance Expense because the grounds maintained are not those of the company. If the employees were paid wages while planting grevilleas, the cost would be recorded as wages expense.

(3) This is a Charitable contribution expense.
(4) Not recorded in the company's financial records at all.

BBS1.6

Communication activity
Stefani Leotta is the trainee accountant for GaGa Fashions Ltd. Stefani has finally got the company's statement of financial position to balance, but as she's still completing her business degree, she isn't sure that it's correct. Before sending the statement to the board of directors, she asks you to check it and prepare a report.

GAGA FASHIONS LTD Statement of financial position for the month ended 30 June			
ASSETS		LIABILITIES AND EQUITY	
Equipment	$36 900	Contributed equity	$48 000
Cash	14 400	Accounts receivable	(30 000)
Supplies	1 680	Inventory	(7 200)
Dividends	4 200	Accounts payable	25 980
		Retained earnings	20 400
Total assets	**$57 180**	**Total liabilities and equity**	**$57 180**

Required
Unfortunately, Stefani has made some fundamental errors. Prepare a report for Stefani using the following structure.

(a) An explanation of the purpose and structure of your report and an overview of the initial findings.
(b) A discussion of the purpose of a statement of financial position and definitions for each of the elements.
(c) The identification of each of the errors in the statement of financial position with an explanation of why they are incorrect and how they can be corrected.
(d) A correct statement of financial position
(e) A discussion of why it is important that the statement of financial position is faithfully represented.
(f) Provide examples of decisions users make, based on the information in general purpose financial statements.

(a)

Gaga Fashions Ltd

Date: DD/MM/YY

Brief Report on Gaga Fashions Financial Statements

(a) Introduction and overview
The purpose of this brief report is to provide feedback on my review of the statement of financial position of Gaga Fashions Ltd as at 30 June. The review revealed that there are some fundamental gaps in your understanding of the nature, purpose and elements in the statement of financial position which has lead to a number of errors in the statement of financial position of Gaga Fashions Ltd as at 30 June.

The remainder of this report is structured as follows:

(b) Purpose of the statement of financial position and definition of the elements;

(c) List of errors in the Statement, why they are incorrect and how to correct them, and;

(d) A corrected statement of financial position for Gaga Fashions Ltd as at 30 June 2026.

(e) Why it is important that the statement of financial position is faithfully represented.

(f) Examples of decisions that four external users make based on general purpose financial statements.

Part (b)

The purpose of a Statement of financial position is to report a company's assets, liabilities and equity at a point in time. It reports what the company controls (assets) and what it owes (liabilities) and the net amount attributed to owners (equity).

Assets are formally defined in the Conceptual Framework as a 'present economic resource controlled by the entity as a result of past events. An economic resource is a right that has the potential to produce economic benefits' (paragraphs 4.3 and 4.4).

Liabilities are formally defined in the Conceptual Framework as a 'present obligation of the entity to transfer an economic resource as a result of past events' (paragraph 4.26).

Equity is defined in the Conceptual Framework as 'the residual interest in the assets of the entity after deducting all of its liabilities' (paragraph 4.63).

Part (c)

A number of items in this Statement of financial position are not correctly reported.

Errors include:

1. The Statement of financial position should be dated as at a specific date not for a period of time. Therefore, it should be stated 'as at 30 June'.

2. Assets are generally listed in order of liquidity. Equipment is therefore usually listed below Supplies on the Statement of financial position. In a classified Statement of financial position, Supplies would be shown as a current-asset and Equipment it would be shown as a non-current asset.

3. Accounts receivable would be shown as an asset and in order of liquidity, is usually reported between Cash and Supplies on the Statement of financial position. In a classified Statement of financial position, Accounts receivable would be shown as a current asset.

4. Inventory should be shown as an asset on the Statement of financial position. In order of liquidity, inventory is usually reported below Cash and Accounts receivable. In a classified Statement of financial position, Inventory would be shown as a current asset.

5. Liabilities and shareholders' equity should be shown separately on the Statement of financial position. Contributed equity, Retained earnings and Dividends are not liabilities.

6. Contributed equity, Retained earnings and Dividends are part of shareholders' equity. The Dividends account is not reported on the Statement of financial position but is subtracted from Retained earnings to arrive at the ending balance.

Part (d)

A corrected Statement of financial position is as follows.

Gaga Fashions Ltd
Statement of financial position
as at 30 June

	$	$
Assets		
Cash		14 400
Accounts receivable		30 000
Inventory		7 200
Supplies		1 680
Equipment		36 900
Total assets		$90 180
Liabilities:		
Accounts payable		$25 980
Total liabilities		$25 980
Equity:		
Contributed equity	48 000	
Retained earnings	*16 200	64 200
Total liabilities and equity		$90 180

* Retained earnings	$20 400
Less: Dividends	(4 200)
Ending retained earnings	$16 200

Part (e)

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential equity investors, lenders and other

creditors in making their decisions about providing resources to the entity. This definition highlights the primary users of **general purpose financial reports** to be existing and potential shareholders, lenders and other creditors.
External users can only make sound decisions when allocating their resources if the information they are using to base their decisions on is faithfully presented.

Part (f)
The following table provides a list of external users and the decisions they make using general purpose financial reports

External Users	Decisions
Investors	Whether to invest based on future profitability, return or capital growth
Creditors	Whether to grant credit based on risks and ability of the entity to repay debts
Customers	Whether an entity will continue to honour product warranties and support its product lines
Employees and trade unions	Whether the entity has the ability to pay increased wages and benefits, and offer job security
Government authorities	Determine the amount of tax owing and whether the entity complies with tax laws
Regulatory agencies	Determine whether the entity is operating within prescribed rules

BBS1.7

Sustainability

The following is an extract from the AGL Energy Limited web site.

> **At AGL, sustainability means thinking about our long-term responsibilities towards our customers, our people, our investors and to our community, and to the environment in which we all work and live.**
>
> **We're focused on delivering affordable, reliable, lower-carbon and innovative energy solutions for all of our customers, including those experiencing financial hardship.**
>
> **To accomplish this, we need to support our people and the communities in which we live and work. We do this by reinvesting in the communities we operate in, and by celebrating and developing our safe, diverse and inclusive workforce. As an essential service provider in a highly regulated industry, we have a responsibility to engage with governments at all levels on energy and related policies.**
>
> **We are also committed to taking a conscientious approach to the environment by actively working to reduce greenhouse gas emissions and manage our environmental footprint.**
>
> **These complex issues — and the actions we are taking — shape our sustainability strategy.**
>
> **We're always listening, learning and reviewing our approach, and measure our performance through our transparent sustainability reporting.**

Source: AGL Energy Limited, www.agl.com.au/about-agl/sustainability.

Required

What is meant by the term sustainability?

Access AGL Energy Limited's latest sustainability responsibility report and:

1. **outline the company's approach to sustainability**
2. **summarise AGL's achievements in health and safety and the environment for the current period. Include a discussion of how these achievements are measured.**

The term **sustainability** is about making decisions considering environmental, social, governance and economic issues and trade-offs. Sustainable development must not just be about economic growth but also environmental quality and social equity.

AGL sustainability report

Background for the lecturer: From 2018 AGL no longer produce a stand alone sustainability report but the information is contained on their website and in their annual report. There is also a climate report.
Student answers will differ.

1. AGL Approach

AGL state on their website that they aim at “Embracing ESG in everything we do”.

“At AGL, our purpose and values reflect our commitment to providing reliable energy solutions for millions of homes and businesses as we play our role in Australia’s energy transition.

Embracing ESG means thinking about the responsibilities we have to our people, customers, investors, communities and the environment in which we operate.

We’re embedding ESG considerations into the work we do and the decisions we make, recognising that our future success is shaped and measured by the social and environmental consequences our decisions and actions have for all our stakeholders.” (https://www.agl.com.au/about-agl/sustainability)

2. AGL’s achievements: results and how measured. For health and safety and the environment only.

Health and safety:
Please refer to website as well as annual report (e.g. 2025 annual report p.33-35)

Environment:
Please refer to website, annual report (e.g. 2025 annual report p. 38-40 and 64-88) and climate statement.

BBS1.8

Ethics case

As the chief financial officer of Mobile Phones Pty Ltd, you discover a significant misstatement that overstated assets in this year's financial statements. The misleading financial statements are contained in the company's annual report, which is about to be issued to banks and other creditors. After much thought about the consequences of telling the managing director, Jack Frost, about this misstatement, you gather your courage to tell him. Jack says, 'What they don't know won't hurt them. But just so we set the record straight, we'll adjust next year's financial statements for this year's misstatement. We can fix it next year when we make more profit. Just don't make that kind of mistake again.'

Required

(a) Who are the stakeholders in this situation?

(b) What are the ethical issues?

(c) What would you do as the chief financial officer?

Mobile Phones Pty Ltd

(a) The stakeholders in this case are:

You, as chief financial officer
Jack Frost, managing director
Users of the company's financial statements.

(b) The ethical issue is the continued circulation of significantly misstated financial statements. As chief financial officer, you have contributed to the preparation of misleading financial statements. Jack Frost and any other directors are responsible for the preparation of the financial statements issued by Mobile Phones Pty Ltd. You have acted ethically by telling the company's managing director. The managing director has reacted unethically by allowing the misleading financial statements to continue to circulate.

(c) As chief financial officer, you have a professional ethical responsibility to attempt to persuade the managing director not to issue misleading financial statements (they would mislead users, cause damage to the company's reputation and possibly incur fines). Other actions that may be considered include reporting the matter to other directors and resigning. If the statements are audited, the matter may be referred to the auditors.

