Accounting Units 1 & 2

Chapter 2 The accounting equation

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Contents

Chapter 2 The accounting equation — 2A The elements and the accounting equation

Theory

Every transaction a business enters into can be described using just **five building blocks**, called the **accounting elements**. Learning to recognise which element an item belongs to is the first skill in Accounting, because every report the business will ever prepare is built by sorting items into these five groups. The five elements are **assets**, **liabilities**, **owner's equity**, **revenues** and **expenses**.

Assets. An **asset** is 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 future economic benefits**. Three ideas matter here: the item must be a **right** the business holds (over cash, over a piece of equipment, or over an amount a customer owes it), that right must have the **potential to produce a future economic benefit** (cash, or something that helps earn cash), and the business must **control** the resource — it decides how the resource is used — as a result of a **past event** such as a purchase or a contribution by the owner. Examples for a service business include **Bank** (cash at bank), **Accounts Receivable** (amounts owed to the business by its credit customers), office **Equipment**, a **Vehicle** and **Supplies** on hand.

Liabilities. A **liability** is a **present obligation** of the entity **to transfer an economic resource as a result of past events**. A liability is something the business **owes**, and settling it will require the business to hand over an economic resource — usually a future payment of cash. Examples include **Accounts Payable** (amounts the business owes its credit suppliers), a **Loan** from a bank, and **GST Clearing** when the business owes net GST to the Australian Taxation Office.

Owner's equity. Owner's equity is the **residual interest** in the assets of the entity after deducting all its liabilities — in other words, the owner's claim on the business's assets. Owner's equity is what the business would owe back to the owner if every asset were turned into cash and every liability paid. It is increased by the owner's **Capital** contributions and by **profit**, and reduced by **Drawings** (assets the owner takes for private use) and by losses. Because the business is treated as **separate from its owner** (the **accounting entity** assumption), the owner's stake is recorded as a separate claim called owner's equity — not mixed in with the owner's private wealth.

Revenues. A **revenue** is an **increase in assets** or a **decrease in liabilities** that results in an **increase in owner's equity**, other than an increase relating to a **contribution by the owner**. For a service business the main revenue is the **fee** earned for providing its service (for example **Service fees** or **Consulting fees**); interest received is another.

Expenses. An **expense** is a **decrease in assets** or an **increase in liabilities** — other than a decrease or increase relating to a **distribution to the owner** — that results in a **decrease in owner's equity**. Examples include **Wages**, **Rent expense**, **Advertising** and **Interest expense**.

How the elements connect. Assets, liabilities and owner's equity describe the business's **financial position** at a point in time — they are the elements of the **Balance Sheet**. Revenues and expenses describe the business's **performance** over a period — they are the elements of the **Income Statement**. The two are linked through owner's equity: a **revenue increases owner's equity** and an **expense decreases owner's equity**, so the profit for a period (revenue minus expenses) flows into the owner's equity that appears on the Balance Sheet. This is why every item must be classified correctly — a fee wrongly recorded as a loan, or a drawing wrongly recorded as an expense, distorts more than one report.

The accounting equation. Because owner's equity is defined as the **residual** left after liabilities are deducted from assets, the three position elements are always in balance. This relationship is the **accounting equation**:

$$A = L + OE$$

that is, **Assets = Liabilities + Owner's equity**. The equation holds **after every single transaction**, which is why a Balance Sheet always balances. It says that everything the business controls (its assets) was funded from one of two sources: amounts **owed to outsiders** (liabilities) or amounts **owed to the owner** (owner's equity).

Rearranging the equation. Because it is an equation, any one element can be found when the other two are known. The three arrangements are:

- **A = L + OE** — add liabilities and owner's equity to find total **assets**.

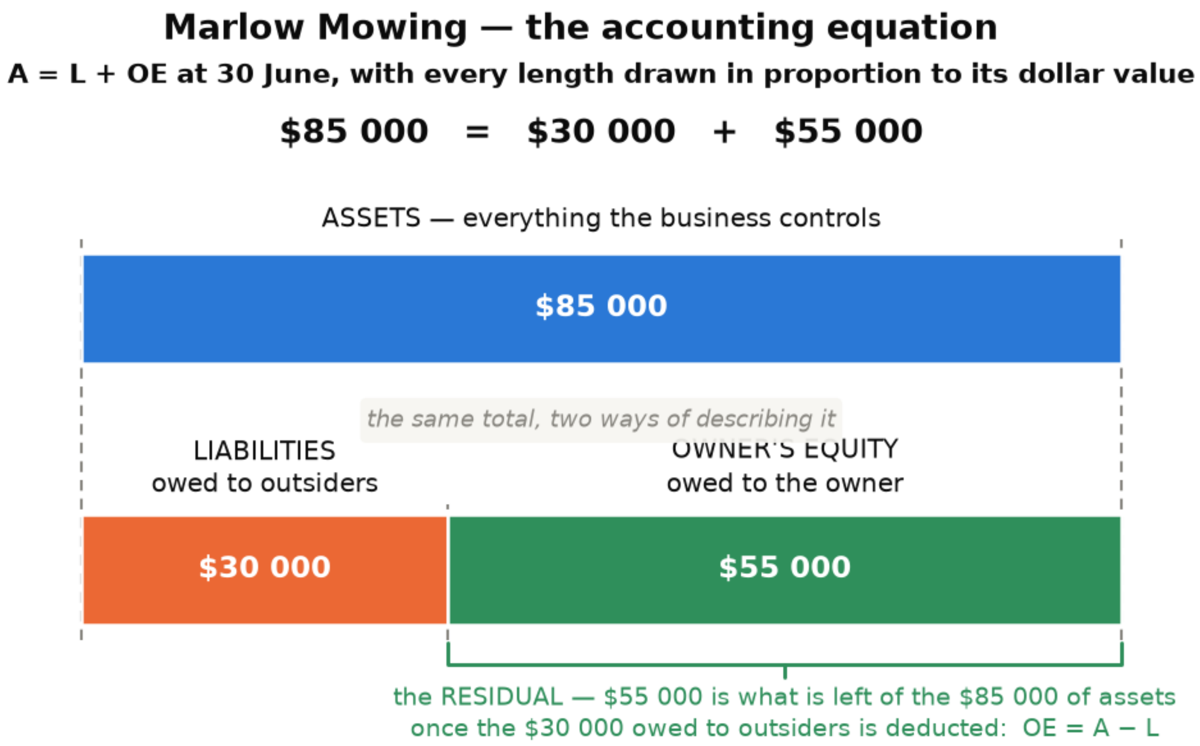
- **OE = A − L** — subtract liabilities from assets to find **owner's equity** (the residual definition).
- **L = A − OE** — subtract owner's equity from assets to find total **liabilities**.

Worked model. *Marlow Mowing* is a lawn-and-garden service business owned by a sole proprietor. At 30 June it controls assets totalling \$85 000 (its bank balance, mowing equipment and a trailer) and owes liabilities of \$30 000 (a bank loan and an amount owing to a supplier). Its owner's equity is the residual:

$$OE = A - L = \$85\,000 - \$30\,000 = \$55\,000$$

Checking the equation, \$85 000 = \$30 000 + \$55 000 — assets equal the two sources that funded them. If a later count showed assets of \$85 000 and owner's equity of \$55 000 but the liabilities figure had been lost, it could be recovered as L = A − OE = \$85 000 − \$55 000 = \$30 000.

Drawing the same three figures to scale shows why the equation must hold. Every length below is in proportion to its dollar value, so the two bars are the same length because \$30 000 + \$55 000 is \$85 000 — not because they have been drawn that way:



Marlow Mowing — the accounting equation A = L + OE, with every length drawn in proportion to its dollar value

Read the top bar as **what the business controls** and the bottom bar as **who funded it**. Owner's equity is the part of the lower bar left over once liabilities have been laid against assets — which is exactly what "residual" means. Because that leftover length is fixed by the other two, an item hidden from the liabilities segment does not shrink the bar; it simply transfers length to the owner's equity segment, and so **overstates the owner's stake** — the ethical point that closes this section.

Ethical considerations. Because owner's equity is a **residual** (OE = A − L), anything that hides a liability or overstates an asset automatically **overstates the owner's stake**. An owner seeking a loan might be tempted to leave a debt out of the records, or to count a private asset as though the business controlled it, so the business looks stronger than it is. Under the **faithful representation** qualitative characteristic the information reported must be **complete**, **free from material error** and **neutral (without bias)**: every liability the business owes must be shown, and only resources the business genuinely **controls** may be reported as assets. Deliberately misclassifying items — recording a personal loan as owner's equity, or a drawing as a business expense — misleads the bank, the ATO and any prospective buyer who relies on the reports, and it breaches the **accounting entity** assumption that keeps the owner's affairs separate from the business's.

Worked examples (scaffolded)

Example 1 — classifying items into the five elements

Harbourview Physiotherapy is a service business. At 1 July its records list the following items: **Bank** $8 000; **physiotherapy equipment** $52 000; **Accounts Receivable** $3 000; **Loan – Meridian Finance** $28 000; **Accounts Payable** $4 000; **Consulting fees**; **Wages**; and the owner's **Capital**. Classify each item into one of the five elements, then calculate the owner's equity.

Working	Comment
Bank, physiotherapy equipment and Accounts Receivable are **assets**.	Each is a present economic resource the business **controls** as a result of a past event, with the potential to produce a future economic benefit (cash, or amounts owed *to* the business).
Loan – Meridian Finance and Accounts Payable are **liabilities**.	Each is a present obligation the business **owes** and will settle by transferring an economic resource — here, by paying cash.
Capital is **owner's equity**; Consulting fees is a **revenue**; Wages is an **expense**.	Capital is the owner's contribution; a fee earned increases owner's equity; wages consumed decrease it.
Total assets = $8 000 + $52 000 + $3 000 = **$63 000**.	Add only the asset items. Consulting fees and Wages are Income Statement elements, not assets.
Total liabilities = $28 000 + $4 000 = **$32 000**.	Add only the items the business owes.
OE = A − L = $63 000 − $32 000 = $31 000.	Owner's equity is the residual. Check: $63 000 = $32 000 + $31 000, so A = L + OE holds.

Example 2 — applying the equation to find a missing figure

For each independent case below, one element of the accounting equation is missing. Calculate it, stating the rearrangement used.

Working	Comment
Case a. Assets $120 000, liabilities $45 000. OE = A − L = $120 000 − $45 000 = **$75 000**.	Owner's equity unknown → subtract liabilities from assets.
Case b. Owner's equity $90 000, liabilities $36 000. A = L + OE = $36 000 + $90 000 = **$126 000**.	Assets unknown → add the two funding sources.
Case c. Assets $150 000, owner's equity $110 000. L = A − OE = $150 000 − $110 000 = **$40 000**.	Liabilities unknown → subtract owner's equity from assets.

In each case the completed triple satisfies A = L + OE, confirming the arithmetic.

Worked examples (unscaffolded)

Example 3 — classify, then determine owner's equity

Cedar Lane Dental controls the following at 30 June: **Bank** $15 000, **dental chairs** $60 000, **Supplies** $2 000 and **Accounts Receivable** $5 000. It owes a **Loan – Unity Bank** of $40 000 and **Accounts Payable** of $6 000. Determine the owner's equity.

The four resources the business controls are assets: total assets = $15 000 + $60 000 + $2 000 + $5 000 = $82 000. The loan and the Accounts Payable are amounts owed: total liabilities = $40 000 + $6 000 = $46 000. Owner's equity is the residual, OE = A − L = $82 000 − $46 000.

∴ owner's equity is **$36 000**, and A = L + OE gives $82 000 = $46 000 + $36 000.

Example 4 — find total assets from liabilities and owner's equity

Ridgeway Consulting has owner's equity (Capital) of $70 000. Its liabilities are a **Loan – Horizon Bank** of $50 000, **Accounts Payable** of $8 000 and **GST Clearing** of $2 000 owing to the ATO. Calculate the total assets the business controls.

Total liabilities = $50 000 + $8 000 + $2 000 = $60 000. The equation gives total assets directly: A = L + OE = $60 000 + $70 000.

∴ the business controls total assets of **$130 000**.

Practice questions — scaffolded

Question 1

Brightpath Tutoring lists the following at 1 April: **Bank** $6 000; **office equipment** $18 000; **Accounts Receivable** $2 500; **Loan – Summit Credit Union** $15 000; **Accounts Payable** $1 500; **Tutoring fees**; **Wages**; and the owner's **Capital**.

a. Classify each item as an asset, a liability, owner's equity, a revenue or an expense.

b. Calculate the total assets.

c. Calculate the total liabilities, and hence the owner's equity.

Question 2

For each independent case, calculate the missing element of the accounting equation and state the rearrangement you used.

a. Assets $95 000, liabilities $38 000, owner's equity ?

b. Owner's equity $62 000, liabilities $29 000, assets ?

c. Assets $140 000, owner's equity $88 000, liabilities ?

Question 3

a. Define an **asset**, and state the three things a business must show for an item to be an asset.

b. Define a **liability**.

c. Define **owner's equity**, and explain how it relates to assets and liabilities.

Question 4

Fernbrook Gardening controls at 30 June: **Bank** $4 500, a **trailer** $22 000, **mowing equipment** $9 500 and **Accounts Receivable** $1 000. It owes a **Loan – Fairview Bank** of $18 000 and **Accounts Payable** of $800.

a. Classify each item as an asset or a liability.

b. Calculate the total assets and the total liabilities.

c. Calculate the owner's equity, and show that A = L + OE.

Question 5

a. *Delta IT Support* has owner's equity of $54 000 and assets of $96 000. Calculate its liabilities.

b. *Aspenwood Design* has liabilities of $33 000 and owner's equity of $47 000. Calculate its assets.

c. State the rearrangement of A = L + OE used to find owner's equity when assets and liabilities are known.

Question 6

Stonegate Accountants lists at 1 July: **Bank** $11 000; **computers** $14 000; **Accounts Receivable** $3 500; **Accounts Payable** $2 500; **GST Clearing** $1 000 (owing to the ATO); **Loan – Pinnacle Bank** $10 000; and **Drawings** taken by the owner.

a. Classify each item as an asset, a liability or owner's equity.

b. Calculate the total assets, the total liabilities and the owner's equity.
c. Explain why **Drawings** is classified as part of owner's equity and not as an expense.

Practice questions — unscaffolded

Question 7

A business has assets of $76 000 and liabilities of $29 000. Calculate its owner's equity.

Question 8

A business has owner's equity of $83 000 and liabilities of $41 000. Calculate its total assets.

Question 9

A business has assets of $168 000 and owner's equity of $120 000. Calculate its liabilities.

Question 10

Aspen Physiotherapy controls **Bank** $9 000, **equipment** $45 000 and **Accounts Receivable** $4 000, and owes a **Loan – Coastal Bank** of $30 000 and **Accounts Payable** of $3 000. Calculate the owner's equity and show that the accounting equation holds.

Question 11

For each item below, name the element it belongs to and state whether it appears in the **Balance Sheet** or the **Income Statement**: a. Accounts Payable b. Service fees c. Rent expense d. Motor vehicle e. Capital f. Interest revenue.

Question 12

Define, in the terms used by the accounting elements, a **revenue** and an **expense**, and in each case state the effect the element has on owner's equity.

Question 13

Brookvale Signage has total assets of $130 000. Its owner's equity is exactly **three times** its liabilities. Calculate the liabilities and the owner's equity.

Question 14

Cove Landscaping owes a **Loan – Meridian Finance** of $40 000 and **Accounts Payable** of $7 500, and has owner's equity of $52 500. Calculate the total assets the business controls.

Question 15

Brookhaven Cleaning has owner's equity of $60 000 and liabilities of $25 000. Its assets are **cleaning equipment** $50 000, a **vehicle** $28 000, **Accounts Receivable** $3 000 and a **Bank** balance that has not yet been recorded. Calculate the Bank balance.

Question 16

Explain how the **revenue** and **expense** elements change owner's equity. *Larkspur Marketing* began the period with owner's equity of $40 000 and, during the period, earned revenue of $25 000 and incurred expenses of $18 000, with no capital contribution and no drawings. Calculate the owner's equity at the end of the period.

Question 17

Kestrel Plumbing is applying for a bank loan. The owner, Dana, controls business assets of $90 000 — which include the business's **work van**, valued at $32 000 — and owes business liabilities of $50 000. Among those liabilities is a $20 000 loan Dana took out to buy that van. Because the loan contract is in Dana's own name, Dana suggests leaving the $20 000 out of the business records "because it's really my own loan", while keeping the van in the business assets; that would report liabilities of $30 000. Calculate the owner's equity that would be reported both with and without the $20 000, and discuss the ethical considerations Dana should weigh, referring to a relevant qualitative characteristic and to the accounting entity assumption.

Question 18

Crestwood Marketing lists at 30 June: **Bank** $13 000; **office furniture** $22 000; **computer equipment** $16 000; **Accounts Receivable** $6 000; **Loan – Vantage Bank** $26 000; **Accounts Payable** $4 000; **GST Clearing** $1 500 (owing to the ATO); **Service fees**; and **Advertising**. a. Classify each item into one of the five elements. b. Calculate the total assets and the total liabilities. c. Calculate the owner's equity and state the accounting equation for the business.

Answers

1.
   b. \$26 500 c. Liabilities \$16 500; owner's equity \$10 000
2.
   a. \$57 000 b. \$91 000 c. \$52 000
3. See solutions
4.
   b. Assets \$37 000; liabilities \$18 800 c. Owner's equity \$18 200
5.
   a. \$42 000 b. \$80 000 c. OE = A − L
6.
   b. Assets \$28 500; liabilities \$13 500; owner's equity \$15 000
7. \$47 000
8. \$124 000
9. \$48 000
10. Owner's equity \$25 000
11.
    a. Liability, Balance Sheet b. Revenue, Income Statement c. Expense, Income Statement d. Asset, Balance Sheet e. Owner's equity, Balance Sheet f. Revenue, Income Statement
12. See solutions
13. Liabilities \$32 500; owner's equity \$97 500
14. \$100 000
15. Bank \$4 000
16. Owner's equity \$47 000
17. Reported OE with the loan \$40 000; without it \$60 000 (overstated by \$20 000); see solutions
18.
    b. Assets \$57 000; liabilities \$31 500 c. Owner's equity \$25 500; \$57 000 = \$31 500 + \$25 500

Fully-worked solutions

Question 1

a. **Assets:** Bank, office equipment, Accounts Receivable. **Liabilities:** Loan – Summit Credit Union, Accounts Payable. **Owner's equity:** Capital. **Revenue:** Tutoring fees. **Expense:** Wages.

b. Total assets = \$6 000 + \$18 000 + \$2 500 = **\$26 500**.

c. Total liabilities = \$15 000 + \$1 500 = **\$16 500**; owner's equity = A − L = \$26 500 − \$16 500 = **\$10 000**. Check: \$26 500 = \$16 500 + \$10 000.

Question 2

a. OE = A − L = \$95 000 − \$38 000 = **\$57 000**.

b. A = L + OE = \$29 000 + \$62 000 = **\$91 000**.

c. L = A − OE = \$140 000 − \$88 000 = **\$52 000**.

Question 3

a. An **asset** is a **present economic resource controlled by the entity as a result of past events**, an economic resource being a **right that has the potential to produce future economic benefits**. The three things to show are that the item is an **economic resource** (a right with the **potential to produce a future economic benefit**), that the business **controls** it, and that the control arose from a **past event**.

b. A **liability** is a **present obligation** of the entity **to transfer an economic resource as a result of past events** — something the business **owes** and will settle by handing over an economic resource, usually cash.

c. **Owner's equity** is the **residual interest** in the assets of the entity after deducting all its liabilities; that is, OE = A − L. It is the owner's claim on the business's assets — the amount left for the owner once every liability has been met.

Question 4

a. **Assets:** Bank, trailer, mowing equipment, Accounts Receivable. **Liabilities:** Loan – Fairview Bank, Accounts Payable.

b. Total assets = $4 500 + $22 000 + $9 500 + $1 000 = **$37 000**; total liabilities = $18 000 + $800 = **$18 800**.

c. Owner's equity = A − L = $37 000 − $18 800 = **$18 200**. Check: $37 000 = $18 800 + $18 200, so A = L + OE.

Question 5

a. L = A − OE = $96 000 − $54 000 = **$42 000**.

b. A = L + OE = $33 000 + $47 000 = **$80 000**.

c. **OE = A − L** — subtract liabilities from assets (the residual definition of owner's equity).

Question 6

a. **Assets:** Bank, computers, Accounts Receivable. **Liabilities:** Accounts Payable, GST Clearing, Loan – Pinnacle Bank. **Owner's equity:** Drawings (a reduction of owner's equity).

b. Total assets = $11 000 + $14 000 + $3 500 = **$28 500**; total liabilities = $2 500 + $1 000 + $10 000 = **$13 500**; owner's equity = A − L = $28 500 − $13 500 = **$15 000**.

c. **Drawings** are assets (usually cash) the owner takes out of the business for **private use**. Under the **accounting entity** assumption the business is separate from its owner, so a drawing is a **distribution to the owner** — a withdrawal of the owner's own stake. The definition of an **expense** specifically excludes decreases in assets that relate to a distribution to the owner, so a drawing can never be an expense: an expense is consumed in **operating the business** to generate revenue, whereas a drawing benefits only the owner. Recording drawings as an expense would **understate profit** and misrepresent owner's equity.

Question 7

OE = A − L = $76 000 − $29 000 = **$47 000**.

Question 8

A = L + OE = $41 000 + $83 000 = **$124 000**.

Question 9

L = A − OE = $168 000 − $120 000 = **$48 000**.

Question 10

Total assets = $9 000 + $45 000 + $4 000 = $58 000; total liabilities = $30 000 + $3 000 = $33 000. Owner's equity = A − L = $58 000 − $33 000 = **$25 000**. Check: $58 000 = $33 000 + $25 000, so A = L + OE.

Question 11

a. Accounts Payable — **liability**, Balance Sheet. b. Service fees — **revenue**, Income Statement.
b. Rent expense — **expense**, Income Statement. d. Motor vehicle — **asset**, Balance Sheet.
c. Capital — **owner's equity**, Balance Sheet. f. Interest revenue — **revenue**, Income Statement.

Question 12

A **revenue** is an **increase in assets** (for example Bank or Accounts Receivable) or a **decrease in liabilities** that results in an **increase in owner's equity**, other than one relating to a **contribution by the owner** — so a revenue **increases** owner's equity. An **expense** is a **decrease in assets** or an **increase in liabilities**, other than one relating to a **distribution to the owner**, that results in a **decrease in owner's equity** — so an expense **decreases** owner's equity.

Question 13

Let liabilities = L. Owner's equity = 3L, so A = L + OE = L + 3L = 4L. Then 4L = $130 000, giving L = $130 000 ÷ 4 = **$32 500**, and owner's equity = 3 × $32 500 = **$97 500**. Check: $130 000 = $32 500 + $97 500.

Question 14

Total liabilities = $40 000 + $7 500 = $47 500. A = L + OE = $47 500 + $52 500 = **$100 000**.

Question 15

Total assets must equal L + OE = $25 000 + $60 000 = $85 000. The recorded assets (excluding Bank) are $50 000 + $28 000 + $3 000 = $81 000, so Bank = $85 000 − $81 000 = **$4 000**. Check: $85 000 = $25 000 + $60 000.

Question 16

A **revenue increases owner's equity** and an **expense decreases owner's equity**; over a period the net effect is the **profit** (revenue − expenses), which is added to owner's equity. Here profit = $25 000 − $18 000 = $7 000, so closing owner's equity = $40 000 + $7 000 = **$47 000** (no capital contribution or drawings adjust it).

Question 17

With the $20 000 loan included, reported owner's equity = A − L = $90 000 − $50 000 = **$40 000**. Leaving the $20 000 out reduces reported liabilities to $30 000, so reported owner's equity = $90 000 − $30 000 = **$60 000** — overstated by $20 000.

Ethically, the test is not whose **name** is on the loan contract but whose **obligation** it is. The loan was taken out to buy the **work van**, and that van is counted among the business's $90 000 of assets, so the obligation belongs to the business. The **accounting entity** assumption requires the business's assets **and** its liabilities to be kept separate from the owner's private affairs — it works in both directions. Keeping the van in the assets while taking the loan out of the liabilities records only one side of the one event, and it is exactly the side that flatters the business. (Had the loan genuinely funded a **private** car, the same assumption would require the loan *and* the car to be kept out of the business records together — never one without the other.) Omitting a business liability also breaches **faithful representation**: the reports would no longer be **complete**, **free from material error** or **neutral (without bias)**, the owner's equity would be overstated by $20 000, and the bank would be misled into lending against a financial position that does not exist. Acting with integrity means classifying the loan according to whose obligation it really is, and disclosing every business liability in full.

Question 18

a. **Assets:** Bank, office furniture, computer equipment, Accounts Receivable. **Liabilities:** Loan – Vantage Bank, Accounts Payable, GST Clearing. **Owner's equity:** (the residual). **Revenue:** Service fees. **Expense:** Advertising.

b. Total assets = $13 000 + $22 000 + $16 000 + $6 000 = **$57 000**; total liabilities = $26 000 + $4 000 + $1 500 = **$31 500**.

c. Owner's equity = A − L = $57 000 − $31 500 = **$25 500**. The accounting equation for the business is **$57 000 = $31 500 + $25 500** (A = L + OE).

Chapter 2 The accounting equation — 2B The Balance Sheet and classification

Theory

The **Balance Sheet** is the accounting report that shows a business's **financial position** — what it controls and what it owes — **at a single point in time**. Because it captures the position on one chosen day, its title always begins **"Balance Sheet … as at <date>"** (for example, *Balance Sheet of Kingsley Plumbing as at 30 June 2025*). This makes it different from reports that cover a *period* of time.

The Balance Sheet reports the three **elements** of the accounting equation:

- an **asset** is a present economic resource controlled by the business as a result of past events, with the potential to produce future economic benefits (Bank, Accounts Receivable, equipment, vehicles);
- a **liability** is a present obligation of the business to transfer an economic resource as a result of past events (Accounts Payable, a loan);
- **owner's equity** is the **residual** interest in the assets of the business after deducting its liabilities — the owner's claim, recorded as **Capital**.

These three elements are locked together by the **accounting equation**, and every Balance Sheet must **balance**:

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

Because owner's equity is defined as *Assets − Liabilities*, the report can never be out of balance if each item is classified and added correctly. Balancing is therefore a built-in check on the work.

Classification and the 12-month test. A *classified* Balance Sheet groups the individual items under **five headings**, always in this order:

1. **Current Assets**
2. **Non-Current Assets** — these two groups add to **Total Assets**
3. **Current Liabilities**
4. **Non-Current Liabilities** — these two groups add to **Total Liabilities**
5. **Owner's Equity**

The split between *current* and *non-current* is decided by the **12-month test** — whether the item will be settled, consumed or converted to cash **within the next 12 months**:

- a **current asset** is cash, or an asset the business reasonably expects to convert to cash or consume **within 12 months** (Bank, Accounts Receivable, Supplies, Prepaid insurance);
- a **non-current asset** is held for use in the business **beyond 12 months** (equipment, motor vehicles, furniture, a term deposit maturing in two years);
- a **current liability** is an obligation due to be settled **within 12 months** (Accounts Payable, the portion of a loan repayable in the coming year);
- a **non-current liability** is an obligation due **beyond 12 months** (the long-term portion of a loan, a mortgage).

Classifying items this way makes the information more **relevant**: a user who wants to judge whether the business can meet its **short-term** debts needs the current items shown separately from the non-current items. A single item can even be **split** across two groups — a $40 000 loan of which $8 000 is repayable in the next 12 months is shown as an $8 000 current liability *and* a $32 000 non-current liability.

The two-column layout. A Balance Sheet uses **two money columns**. The **inner column** lists the individual amounts that make up a group; the **outer column** records each group's **sub-total** and the report's **totals**. A group made up of a single item is written straight into the outer column. The report closes with **Total Liabilities and Owner's Equity**, which must equal **Total Assets**.

Worked model. Kingsley Plumbing (owner R. Kingsley) controls, at 30 June 2025: Bank $3 000, Accounts Receivable $2 400, Supplies $600, Equipment $14 000 and a Motor vehicle $22 000. It owes Accounts Payable $4 000 and a Loan from Meridian Bank of $18 000 (repayable over four years). The owner's Capital is $20 000. Classifying each item and setting it out gives:

Balance Sheet of Kingsley Plumbing as at 30 June 2025

	$	$
Current Assets		
Bank	3 000	
Accounts Receivable	2 400	
Supplies	600	6 000
Non-Current Assets		
Equipment	14 000	
Motor vehicle	22 000	36 000
Total Assets		42 000
Current Liabilities		
Accounts Payable		4 000
Non-Current Liabilities		
Loan – Meridian Bank		18 000
Total Liabilities		22 000
Owner's Equity		
Capital		20 000
Total Liabilities and Owner's Equity		42 000

Total Assets of $42 000 equal Total Liabilities plus Owner's Equity ($22 000 + $20 000), so the report balances. Reading down it, a user learns that of the $42 000 of resources the business controls, outside parties financed $22 000 and the owner financed $20 000.

Ethical considerations. How an item is classified is a judgement, and that judgement can be misused. Reporting a liability that is really due next month as *non-current*, or a long-term loan as *current*, does not change the total owed — but it changes the picture of the business's **short-term** ability to pay its debts. An owner seeking finance might be tempted to nudge items between the current and non-current groups to make the business look more able to meet its obligations than it truly is. A sole trader is not obliged by law to prepare a Balance Sheet at all, so the discipline here is an **ethical** one: the owner and whoever prepares the report have a responsibility to lenders, suppliers and any other user who relies on it to apply the 12-month test **honestly and consistently**, so that the report is a **faithful representation** of the financial position — complete, free from material error and neutral (without bias) — rather than a flattering one. Where a deliberately distorted report is then used to obtain finance or credit, the conduct goes beyond an ethical failing and can expose the owner to legal action for misleading the lender or supplier.

Worked examples (scaffolded)

Example 1 — classifying a list of items and preparing a classified Balance Sheet

Harborview Dental (owner S. Nguyen) provides dental services. At 30 June 2025 the business had the following items, in no particular order: Motor vehicle $25 000; Bank $5 500; Accounts Payable $6 000; Dental equipment $40 000; Loan – Coastwide Bank $37 000 (repayable over six years); Prepaid insurance $1 000 (cover expiring in nine months); Furniture $8 000; Accounts Receivable $3 500; Capital $40 000. Prepare a classified Balance Sheet.

Working	Comment
Apply the 12-month test to each asset. Bank, Accounts Receivable and Prepaid insurance (nine months) are **current assets**.	Cash, amounts to be received within a year, and a prepayment consumed within a year are all current.
Dental equipment, Furniture and the Motor vehicle are **non-current assets** — held for use beyond 12 months.	Assets used to run the practice, not converted to cash within the year, are non-current.
Current Assets = $5 500 + $3 500 + $1 000 = **$10 000**; Non-Current Assets = $40 000 + $8 000 + $25 000 =	Add each group in the inner column; its sub-total goes to

Working	Comment
$73 000.	the outer column.
Total Assets = $10 000 + $73 000 = **$83 000**.	The two asset sub-totals give Total Assets.
Accounts Payable is a **current liability**; the six-year Loan is a **non-current liability**. Total Liabilities = $6 000 + $37 000 = **$43 000**.	The loan is due beyond 12 months, so it is non-current.
Capital $40 000 is **owner's equity**. Check: $43 000 + $40 000 = **$83 000** = Total Assets.	The report balances because Owner's Equity = Assets − Liabilities.

Balance Sheet of Harborview Dental as at 30 June 2025

	$	$
Current Assets		
Bank	5 500	
Accounts Receivable	3 500	
Prepaid insurance	1 000	10 000
Non-Current Assets		
Dental equipment	40 000	
Furniture	8 000	
Motor vehicle	25 000	73 000
Total Assets		83 000
Current Liabilities		
Accounts Payable		6 000
Non-Current Liabilities		
Loan – Coastwide Bank		37 000
Total Liabilities		43 000
Owner's Equity		
Capital		40 000
Total Liabilities and Owner's Equity		83 000

Example 2 — finding a missing figure (Capital) as the residual

Brightpath Fitness (owner L. Adamos) has, at 31 December 2025: Bank $4 200, Accounts Receivable $1 800, Gym equipment $32 000, Leasehold improvements $10 000, Accounts Payable $3 500 and a Loan from Uptown Finance of $24 500 (repayable over five years). The owner cannot find the figure for Capital. Determine Capital and prepare the classified Balance Sheet.

Working	Comment
Total Assets = current ($4 200 + $1 800 = $6 000) + non-current ($32 000 + $10 000 = $42 000) = **$48 000**.	Classify and total the assets first.
Total Liabilities = current $3 500 + non-current $24 500 = **$28 000**.	Accounts Payable is current; the five-year loan is non-current.
Capital = Assets − Liabilities = $48 000 − $28 000 = **$20 000**.	Owner's equity is the **residual** — rearranging the accounting equation gives the missing figure.
Check the report balances: $28 000 + $20 000 = **$48 000** = Total Assets.	If Capital is found this way, the Balance Sheet must balance.

Balance Sheet of Brightpath Fitness as at 31 December 2025

	$	$
Current Assets		
Bank	4 200	
Accounts Receivable	1 800	6 000
Non-Current Assets		
Gym equipment	32 000	
Leasehold improvements	10 000	42 000
Total Assets		48 000
Current Liabilities		
Accounts Payable		3 500
Non-Current Liabilities		
Loan – Uptown Finance		24 500
Total Liabilities		28 000
Owner's Equity		
Capital		20 000
Total Liabilities and Owner's Equity		48 000

Worked examples (unscaffolded)

Example 3 — correcting a misclassification

A trainee prepared the Balance Sheet of Summit Landscaping (owner D. Petrou) as at 30 June 2025 but made two classification errors: the **Prepaid rent** of $1 200 (cover expiring in three months) was shown as a non-current asset, and the **Loan – Parkland Bank** of $30 000 (repayable over five years) was shown as a current liability. The remaining items were correct: Bank $2 800, Accounts Receivable $4 000, Equipment $26 000, Motor vehicle $16 000, Accounts Payable $5 000, Capital $15 000. Restate the Balance Sheet correctly and explain the effect of the corrections.

Applying the 12-month test, the Prepaid rent expires within three months, so it is a **current asset**; the loan is repayable over five years, so it is a **non-current liability**. Neither correction changes Total Assets ($50 000) or Total Liabilities ($35 000) — the items simply move to the right group — but the trainee's version understated Current Assets by $1 200 (reported $6 800 instead of $8 000) and overstated Current Liabilities by $30 000 (reported $35 000 instead of $5 000). The corrected report gives a truthful view of the business's short-term position.

Balance Sheet of Summit Landscaping as at 30 June 2025

	$	$
Current Assets		
Bank	2 800	
Accounts Receivable	4 000	
Prepaid rent	1 200	8 000
Non-Current Assets		
Equipment	26 000	
Motor vehicle	16 000	42 000
Total Assets		50 000
Current Liabilities		
Accounts Payable		5 000
Non-Current Liabilities		
Loan – Parkland Bank		30 000

	$	$
Total Liabilities		35 000
Owner's Equity		
Capital		15 000
Total Liabilities and Owner's Equity		50 000

∴ correctly classified, Current Assets are $8 000 and Current Liabilities are $5 000; the report still balances at $50 000.

Example 4 — splitting a loan across current and non-current

Cedar Creek Vet (owner H. Okonkwo) has, at 30 June 2025: Bank $6 000, Accounts Receivable $5 000, Supplies $1 000, Veterinary equipment $45 000, Motor vehicle $23 000, Accounts Payable $7 000 and Capital $33 000. It also has a Loan from Riverstone Bank of $40 000, of which $8 000 is repayable within the next 12 months and the remaining $32 000 beyond 12 months. Prepare the classified Balance Sheet.

The $8 000 of the loan due within a year is a **current liability**; the $32 000 due later is a **non-current liability**, so the one debt appears on two lines. Current Assets total $12 000, Non-Current Assets $68 000, giving Total Assets of $80 000. Total Liabilities are $15 000 current plus $32 000 non-current = $47 000, and with Capital of $33 000 the report balances at $80 000.

Balance Sheet of Cedar Creek Vet as at 30 June 2025

	$	$
Current Assets		
Bank	6 000	
Accounts Receivable	5 000	
Supplies	1 000	12 000
Non-Current Assets		
Veterinary equipment	45 000	
Motor vehicle	23 000	68 000
Total Assets		80 000
Current Liabilities		
Accounts Payable	7 000	
Loan – Riverstone Bank (current portion)	8 000	15 000
Non-Current Liabilities		
Loan – Riverstone Bank		32 000
Total Liabilities		47 000
Owner's Equity		
Capital		33 000
Total Liabilities and Owner's Equity		80 000

∴ the same $40 000 loan is reported as $8 000 current and $32 000 non-current, and the Balance Sheet balances at $80 000.

Practice questions — scaffolded

Question 1

Ridgeway Electrical (owner M. Cole) is an electrical-services business. At 30 June 2025 it had: Bank $4 000; Accounts Receivable $3 000; Tools & equipment $12 000; Motor vehicle $21 000; Accounts Payable $5 000; Loan – Fairview Bank $15 000 (repayable over four years); Capital $20 000.

a. Classify each item as a current asset, non-current asset, current liability, non-current liability or owner's equity.

b. Prepare a classified Balance Sheet as at 30 June 2025.

c. State the total assets of the business.

Question 2

Blue Sky Photography (owner R. Iqbal) has, at 31 December 2025: Bank $2 500; Accounts Receivable $1 500; Supplies $1 000; Camera equipment $18 000; Computer equipment $7 000; Accounts Payable $4 000; Loan – Delta Credit Union $11 000 (repayable over three years). The figure for Capital is missing.

a. Calculate Total Assets and Total Liabilities.

b. Calculate the missing Capital.

c. Prepare a classified Balance Sheet as at 31 December 2025.

Question 3

Parkside Physiotherapy (owner J. Marsh) has, at 30 June 2025: Bank $3 000; Accounts Receivable $2 000; Prepaid insurance $500 (cover expiring in eight months); a Term deposit of $10 000 (maturing in two years); Equipment $16 500; Furniture $3 000; Accounts Payable $3 000; Loan – Horizon Bank $12 000 (repayable over five years); Capital $20 000.

a. Using the 12-month test, state whether the Prepaid insurance and the Term deposit are current or non-current assets, giving a reason for each.

b. Prepare a classified Balance Sheet as at 30 June 2025.

c. State the total assets of the business.

Question 4

A junior clerk prepared the Balance Sheet of Willowbrook Consulting (owner F. Della) as at 30 June 2025 but classified the **Motor vehicle** $25 000 as a current asset and the **Accounts Payable** $6 000 as a non-current liability. The other items were correct: Bank $5 000; Accounts Receivable $4 000; Office equipment $11 000; Loan – Summit Bank $14 000 (repayable over five years); Capital $25 000.

a. Identify the correct classification of the Motor vehicle and of the Accounts Payable.

b. Prepare a corrected classified Balance Sheet as at 30 June 2025.

c. State the effect of the two corrections on Total Current Assets.

Question 5

Grange Mechanical (owner T. Blakely) has, at 30 June 2025: Bank $3 500; Accounts Receivable $2 500; Supplies $1 000; Workshop equipment $28 000; Motor vehicle $15 000; Accounts Payable $5 000; Loan – Eastbank $25 000 (repayable over six years); Capital $20 000.

a. Prepare a classified Balance Sheet as at 30 June 2025.

b. State how much of the business's assets was financed by external parties and how much by the owner.

c. Explain, in one sentence, why owner's equity is described as the *residual* interest in the assets.

Question 6

Harmony Music School (owner P. Rossi) has, at 31 December 2025: Accounts Receivable $2 000; Instruments $20 000; Furniture $5 000; Computer equipment $4 000; Accounts Payable $3 000; Loan – Crestwood Bank $10 000 (repayable over four years); Capital $25 000. The Bank balance is not listed, but the business knows its **Total Assets are $38 000**.

a. State which of the listed items are non-current assets, and calculate their total.

b. Using Total Assets, calculate the missing Bank balance.

c. Prepare a classified Balance Sheet as at 31 December 2025.

Practice questions — unscaffolded

Question 7

Tanglewood Gardening (owner K. Vella) has, at 30 June 2025: Bank $2 000; Accounts Receivable $3 000; Supplies $1 500; Equipment $9 500; Motor vehicle $18 000; Trailer $6 000; Accounts Payable $4 500; Loan – Greenline Bank $20 500 (repayable over five years); Capital $15 000. Prepare a classified Balance Sheet and state Total Liabilities.

Question 8

Seabreeze Cleaning (owner N. Farah) has, at 30 June 2025: Bank $3 000; Accounts Receivable $2 000; Equipment $15 000; Motor vehicle $20 000; Accounts Payable $4 000; Capital $26 000. The business also has a single non-current Loan from Baytown Bank, but the amount has been lost. Given that the Balance Sheet balances, calculate the missing Loan and prepare the classified Balance Sheet.

Question 9

Fairfield Dance Studio (owner A. Sorrell) has, at 30 June 2025: Bank $4 000; Accounts Receivable $2 000; Prepaid rent $2 000; Equipment $22 000; Fit-out $20 000; Accounts Payable $3 000; Capital $23 000. It has a Loan from Metro Finance of $24 000, of which $6 000 is repayable within the next 12 months and $18 000 beyond. Prepare a classified Balance Sheet, showing the loan split across the correct groups.

Question 10

A trainee prepared the Balance Sheet of Oakleigh Tiling (owner G. Homes) as at 30 June 2025 but had shown the **Prepaid insurance** $1 000 (cover expiring in four months) as a non-current asset and the **Loan – Ridgemont Bank** $25 000 (repayable over six years) as a current liability. The remaining items were correct: Bank $3 500; Accounts Receivable $2 500; Equipment $18 000; Motor vehicle $20 000; Accounts Payable $5 000; Capital $15 000. Prepare the corrected classified Balance Sheet, and state the effect of correcting the loan error on Total Current Liabilities.

Question 11

Northgate Signs (owner B. Ashworth) has, at 30 June 2025: Bank $2 000; Accounts Receivable $4 000; Supplies $2 000; Equipment $30 000; Motor vehicle $22 000; Accounts Payable $6 000; Loan – Vantage Bank $34 000 (repayable over seven years); Capital $20 000. Prepare a classified Balance Sheet, then state the proportion of the business's assets financed by external parties and interpret what this tells a user about who has the greater claim on the assets.

Question 12

Delridge Removals (owner C. Nkemelu) has, at 30 June 2025: Bank $5 000; Accounts Receivable $3 000; Removal truck $40 000; Equipment $12 000; Accounts Payable $7 000; Loan – Portside Finance $28 000 (repayable over six years). Capital is not given. Calculate Capital as the residual and prepare the classified Balance Sheet.

Question 13

Cornerstone IT Services (owner V. Rahim) has, at 30 June 2025: Bank $6 000; Accounts Receivable $4 000; Prepaid subscription $1 000 (expiring in five months); a Term deposit $8 000 (maturing in three years); Computer servers $18 000; Office furniture $4 000; Accounts Payable $3 000. It has a Loan from Zenith Bank of $18 000, of which $4 000 is repayable within 12 months and $14 000 beyond. Classify each item using the 12-month test, calculate Capital as the residual, and prepare the classified Balance Sheet.

Question 14

Brookdale Hairdressing (owner S. Toma) has, at 31 December 2025: Bank $2 200; Accounts Receivable $800; Supplies $1 000; Salon equipment $14 000; Furniture & fittings $6 000; Accounts Payable $2 000; Loan – Coastal Credit Union $10 000 (repayable over four years); Capital $12 000. Prepare a classified Balance Sheet as at 31 December 2025.

Question 15

Kingsford Couriers (owner D. Almasi) reports the following totals. At 1 July 2024: Assets $55 000, Liabilities $30 000. At 30 June 2025: Assets $68 000, Liabilities $33 000. Using the accounting equation, calculate the owner's equity at each date and the change in owner's equity over the year, and state whether the owner's claim on the business grew or shrank.

Question 16

Aspen Plumbing and Birch Plumbing each report Total Assets of $50 000 at 30 June 2025. Aspen has Total Liabilities of $35 000 and Owner's Equity of $15 000; Birch has Total Liabilities of $10 000 and Owner's Equity of $40 000. For each business, calculate the proportion of assets financed by external parties, and discuss which business is more reliant on external finance and one implication of that reliance.

Question 17

The owner of Larkspur Interiors is applying to a bank for a loan and asks the bookkeeper to make two changes to the Balance Sheet before it is sent: to reclassify a large Accounts Payable amount (due next month) as a *non-current* liability, and to show the whole of a five-year loan as *non-current* even though part of it is repayable within the year, so that the business's short-term position looks stronger. Discuss the ethical considerations raised by the owner's request, including the effect on the bank and on other users of the Balance Sheet, and state what the bookkeeper should do.

Question 18

Meridian Engineering (owner W. Castellano) has, at 30 June 2025: Bank $6 000; Accounts Receivable $8 000; Prepaid insurance $1 000; Supplies $3 000; Plant & equipment $60 000; Motor vehicles $30 000; Land & buildings $92 000; Accounts Payable $12 000; Capital $80 000. It has a Loan from Summit Bank of $60 000, of which $8 000 is repayable within 12 months and $52 000 beyond, and a Mortgage from Summit Bank of $48 000 (repayable over 20 years). Prepare a classified Balance Sheet, state Total Assets, and interpret how the business's assets are financed.

Answers

1.
    c. Total Assets $40 000
2.
    a. Total Assets $30 000, Total Liabilities $15 000 b. Capital $15 000
3.
    a. Prepaid insurance = current, Term deposit = non-current c. Total Assets $35 000
4.
    a. Motor vehicle = non-current asset, Accounts Payable = current liability c. Total Current Assets fall by $25 000 (from $34 000 to $9 000)
5.
    b. External $30 000 (60%), owner $20 000 (40%)
6.
    a. Non-current assets $29 000 b. Bank $7 000
7. Total Liabilities $25 000 (Total Assets $40 000; Capital $15 000)
8. Loan – Baytown Bank $10 000 (Total Assets $40 000)
9. Balances at $50 000; Current Liabilities $9 000, Non-Current Liabilities $18 000
10. Corrected Total Current Liabilities $5 000 (the loan error alone reduces them by $25 000); balances at $45 000
11. External $40 000 (about 67%), owner $20 000 (about 33%)
12. Capital $25 000 (Total Assets $60 000)
13. Total Assets $41 000; Capital $20 000; Current Liabilities $7 000, Non-Current Liabilities $14 000
14. Total Assets $24 000; balances
15. Owner’s equity $25 000 → $35 000; increase $10 000 (the owner’s claim grew)
16. Aspen external 70%, Birch external 20%; Aspen is more reliant on external finance
17. See solutions
18. Total Assets $200 000; Total Liabilities $120 000; Capital $80 000

Fully-worked solutions

Question 1

a. Current assets: Bank, Accounts Receivable. Non-current assets: Tools & equipment, Motor vehicle. Current liability: Accounts Payable. Non-current liability: Loan – Fairview Bank. Owner’s equity: Capital.

Balance Sheet of Ridgeway Electrical as at 30 June 2025

	$	$
Current Assets		
Bank	4 000	
Accounts Receivable	3 000	7 000
Non-Current Assets		
Tools & equipment	12 000	
Motor vehicle	21 000	33 000
Total Assets		40 000
Current Liabilities		
Accounts Payable		5 000
Non-Current Liabilities		
Loan – Fairview Bank		15 000
Total Liabilities		20 000

	$	$
Owner's Equity		
Capital		20 000
Total Liabilities and Owner's Equity		40 000

c. Total Assets = **$40 000**.

Question 2

a. Total Assets = current ($2 500 + $1 500 + $1 000 = $5 000) + non-current ($18 000 + $7 000 = $25 000) = **$30 000**. Total Liabilities = $4 000 + $11 000 = **$15 000**.

b. Capital = Assets − Liabilities = $30 000 − $15 000 = **$15 000**.

Balance Sheet of Blue Sky Photography as at 31 December 2025

	$	$
Current Assets		
Bank	2 500	
Accounts Receivable	1 500	
Supplies	1 000	5 000
Non-Current Assets		
Camera equipment	18 000	
Computer equipment	7 000	25 000
Total Assets		30 000
Current Liabilities		
Accounts Payable		4 000
Non-Current Liabilities		
Loan – Delta Credit Union		11 000
Total Liabilities		15 000
Owner's Equity		
Capital		15 000
Total Liabilities and Owner's Equity		30 000

Question 3

a. The Prepaid insurance expires within eight months (under 12), so it is a **current asset**. The Term deposit matures in two years (beyond 12 months), so it is a **non-current asset**.

Balance Sheet of Parkside Physiotherapy as at 30 June 2025

	$	$
Current Assets		
Bank	3 000	
Accounts Receivable	2 000	
Prepaid insurance	500	5 500
Non-Current Assets		
Term deposit	10 000	
Equipment	16 500	
Furniture	3 000	29 500

	$	$
Total Assets		35 000
Current Liabilities		
Accounts Payable		3 000
Non-Current Liabilities		
Loan – Horizon Bank		12 000
Total Liabilities		15 000
Owner's Equity		
Capital		20 000
Total Liabilities and Owner's Equity		35 000

c. Total Assets = **$35 000**.

Question 4

a. The Motor vehicle is a **non-current asset** (held for use beyond 12 months); the Accounts Payable is a **current liability** (due within 12 months).

Balance Sheet of Willowbrook Consulting as at 30 June 2025

	$	$
Current Assets		
Bank	5 000	
Accounts Receivable	4 000	9 000
Non-Current Assets		
Office equipment	11 000	
Motor vehicle	25 000	36 000
Total Assets		45 000
Current Liabilities		
Accounts Payable		6 000
Non-Current Liabilities		
Loan – Summit Bank		14 000
Total Liabilities		20 000
Owner's Equity		
Capital		25 000
Total Liabilities and Owner's Equity		45 000

c. The clerk's version had included the Motor vehicle in Current Assets, giving Total Current Assets of $34 000 ($5 000 + $4 000 + $25 000). Correctly classified, Total Current Assets are $9 000 — a fall of **$25 000**.

Question 5

Balance Sheet of Grange Mechanical as at 30 June 2025

	$	$
Current Assets		
Bank	3 500	
Accounts Receivable	2 500	
Supplies	1 000	7 000

	$	$
Non-Current Assets		
Workshop equipment	28 000	
Motor vehicle	15 000	43 000
Total Assets		50 000
Current Liabilities		
Accounts Payable		5 000
Non-Current Liabilities		
Loan – Eastbank		25 000
Total Liabilities		30 000
Owner's Equity		
Capital		20 000
Total Liabilities and Owner's Equity		50 000

b. External parties (Accounts Payable + Loan) financed Total Liabilities of $30 000 — **60%** of the $50 000 of assets — and the owner financed $20 000 (**40%**).

c. Owner's equity is the *residual* because it is whatever is left of the assets once all liabilities have been met — Assets ($50 000) − Liabilities ($30 000) = $20 000 — so the owner's claim ranks behind that of external parties.

Question 6

a. The non-current assets are Instruments $20 000, Furniture $5 000 and Computer equipment $4 000 = **$29 000**.

b. Total Current Assets = Total Assets − Non-Current Assets = $38 000 − $29 000 = $9 000. Current Assets are Bank + Accounts Receivable, so Bank = $9 000 − $2 000 = **$7 000**.

Balance Sheet of Harmony Music School as at 31 December 2025

	$	$
Current Assets		
Bank	7 000	
Accounts Receivable	2 000	9 000
Non-Current Assets		
Instruments	20 000	
Furniture	5 000	
Computer equipment	4 000	29 000
Total Assets		38 000
Current Liabilities		
Accounts Payable		3 000
Non-Current Liabilities		
Loan – Crestwood Bank		10 000
Total Liabilities		13 000
Owner's Equity		
Capital		25 000
Total Liabilities and Owner's Equity		38 000

Question 7

Balance Sheet of Tanglewood Gardening as at 30 June 2025

	$	$
Current Assets		
Bank	2 000	
Accounts Receivable	3 000	
Supplies	1 500	6 500
Non-Current Assets		
Equipment	9 500	
Motor vehicle	18 000	
Trailer	6 000	33 500
Total Assets		40 000
Current Liabilities		
Accounts Payable		4 500
Non-Current Liabilities		
Loan – Greenline Bank		20 500
Total Liabilities		25 000
Owner's Equity		
Capital		15 000
Total Liabilities and Owner's Equity		40 000

Total Liabilities = **$25 000**.

Question 8

Total Assets = current ($3 000 + $2 000 = $5 000) + non-current ($15 000 + $20 000 = $35 000) = $40 000. Since the report must balance, Total Liabilities = Total Assets − Capital = $40 000 − $26 000 = $14 000. Accounts Payable is $4 000, so the missing Loan = $14 000 − $4 000 = **$10 000**.

Balance Sheet of Seabreeze Cleaning as at 30 June 2025

	$	$
Current Assets		
Bank	3 000	
Accounts Receivable	2 000	5 000
Non-Current Assets		
Equipment	15 000	
Motor vehicle	20 000	35 000
Total Assets		40 000
Current Liabilities		
Accounts Payable		4 000
Non-Current Liabilities		
Loan – Baytown Bank		10 000
Total Liabilities		14 000
Owner's Equity		
Capital		26 000
Total Liabilities and Owner's Equity		40 000

Question 9

The $6 000 of the loan due within 12 months is a current liability; the $18 000 due later is non-current.

Balance Sheet of Fairfield Dance Studio as at 30 June 2025

	$	$
Current Assets		
Bank	4 000	
Accounts Receivable	2 000	
Prepaid rent	2 000	8 000
Non-Current Assets		
Equipment	22 000	
Fit-out	20 000	42 000
Total Assets		50 000
Current Liabilities		
Accounts Payable	3 000	
Loan – Metro Finance (current portion)	6 000	9 000
Non-Current Liabilities		
Loan – Metro Finance		18 000
Total Liabilities		27 000
Owner's Equity		
Capital		23 000
Total Liabilities and Owner's Equity		50 000

Question 10

The Prepaid insurance (four months) is a current asset and the Loan (six years) is a non-current liability. Correcting the loan error moves $25 000 out of Current Liabilities: the trainee's version reported Total Current Liabilities of $30 000 ($5 000 + $25 000), whereas the corrected figure is **$5 000** — a reduction of **$25 000**.

Balance Sheet of Oakleigh Tiling as at 30 June 2025

	$	$
Current Assets		
Bank	3 500	
Accounts Receivable	2 500	
Prepaid insurance	1 000	7 000
Non-Current Assets		
Equipment	18 000	
Motor vehicle	20 000	38 000
Total Assets		45 000
Current Liabilities		
Accounts Payable		5 000
Non-Current Liabilities		
Loan – Ridgemont Bank		25 000
Total Liabilities		30 000

	$	$
Owner's Equity		
Capital		15 000
Total Liabilities and Owner's Equity		45 000

Question 11

Balance Sheet of Northgate Signs as at 30 June 2025

	$	$
Current Assets		
Bank	2 000	
Accounts Receivable	4 000	
Supplies	2 000	8 000
Non-Current Assets		
Equipment	30 000	
Motor vehicle	22 000	52 000
Total Assets		60 000
Current Liabilities		
Accounts Payable		6 000
Non-Current Liabilities		
Loan – Vantage Bank		34 000
Total Liabilities		40 000
Owner's Equity		
Capital		20 000
Total Liabilities and Owner's Equity		60 000

External parties financed Total Liabilities of $40 000, which is $40 000 ÷ $60 000 = about **67%** of the assets; the owner financed $20 000, about **33%**. This tells a user that outside parties (the supplier and the bank) currently have the larger claim on the business's assets — for every $1 of assets, roughly 67c is owed to others and only 33c represents the owner's residual interest.

Question 12

Total Assets = current ($5 000 + $3 000 = $8 000) + non-current ($40 000 + $12 000 = $52 000) = $60 000. Total Liabilities = $7 000 + $28 000 = $35 000. Capital = Assets − Liabilities = $60 000 − $35 000 = **$25 000**.

Balance Sheet of Delridge Removals as at 30 June 2025

	$	$
Current Assets		
Bank	5 000	
Accounts Receivable	3 000	8 000
Non-Current Assets		
Removal truck	40 000	
Equipment	12 000	52 000
Total Assets		60 000
Current Liabilities		

	$	$
Accounts Payable		7 000
Non-Current Liabilities		
Loan – Portside Finance		28 000
Total Liabilities		35 000
Owner's Equity		
Capital		25 000
Total Liabilities and Owner's Equity		60 000

Question 13

Applying the 12-month test: Bank, Accounts Receivable and the Prepaid subscription (five months) are current assets; the Term deposit (three years), Computer servers and Office furniture are non-current assets; Accounts Payable and the $4 000 current portion of the loan are current liabilities; the $14 000 balance of the loan is a non-current liability. Total Assets = $11 000 + $30 000 = $41 000; Total Liabilities = $7 000 + $14 000 = $21 000; Capital = $41 000 − $21 000 = **$20 000**.

Balance Sheet of Cornerstone IT Services as at 30 June 2025

	$	$
Current Assets		
Bank	6 000	
Accounts Receivable	4 000	
Prepaid subscription	1 000	11 000
Non-Current Assets		
Term deposit	8 000	
Computer servers	18 000	
Office furniture	4 000	30 000
Total Assets		41 000
Current Liabilities		
Accounts Payable	3 000	
Loan – Zenith Bank (current portion)	4 000	7 000
Non-Current Liabilities		
Loan – Zenith Bank		14 000
Total Liabilities		21 000
Owner's Equity		
Capital		20 000
Total Liabilities and Owner's Equity		41 000

Question 14

Balance Sheet of Brookdale Hairdressing as at 31 December 2025

	$	$
Current Assets		
Bank	2 200	
Accounts Receivable	800	

	$	$
Supplies	1 000	4 000
Non-Current Assets		
Salon equipment	14 000	
Furniture & fittings	6 000	20 000
Total Assets		24 000
Current Liabilities		
Accounts Payable		2 000
Non-Current Liabilities		
Loan – Coastal Credit Union		10 000
Total Liabilities		12 000
Owner's Equity		
Capital		12 000
Total Liabilities and Owner's Equity		24 000

Question 15

Owner's equity = Assets − Liabilities. At 1 July 2024: $55 000 − $30 000 = **$25 000**. At 30 June 2025: $68 000 − $33 000 = **$35 000**. The change is $35 000 − $25 000 = an **increase of $10 000**, so the owner's claim on the business grew over the year — the assets rose by $13 000 while the liabilities rose by only $3 000, and the $10 000 difference belongs to the owner.

Question 16

For Aspen: external parties financed $35 000 of the $50 000 of assets = $35 000 ÷ $50 000 = **70%** (the owner financed 30%). For Birch: external parties financed $10 000 ÷ $50 000 = **20%** (the owner financed 80%). **Aspen is far more reliant on external finance** — outside parties have claim over 70c in every $1 of its assets, compared with just 20c for Birch. One implication is that Aspen carries greater **risk**: it must service and repay a much larger amount owed to outsiders, and a fall in trade would leave it less able to meet those obligations than Birch, whose position is financed mainly by the owner.

Question 17

Both changes the owner has asked for would misclassify liabilities so that the business's **short-term** obligations appear smaller than they really are, making it look better able to pay its debts when applying for the loan. This breaches the qualitative characteristic of **faithful representation** — the report would no longer be complete, free from material error and neutral (without bias) — and it is not merely a presentation choice but a deliberate attempt to mislead. The bank relies on the Balance Sheet to assess whether the business can repay; a distorted current/non-current split could lead it to lend on false information, exposing the bank to loss and the owner to the loss of trust (and possible legal consequences) when the true position emerges. Other users — suppliers deciding whether to extend credit, for example — would be misled in the same way. Ethically, the bookkeeper has a responsibility to all users of the report, not only to the owner: they should **refuse to make the changes**, explain that each item must be classified by the 12-month test honestly and consistently, and prepare the Balance Sheet showing the Accounts Payable and the current portion of the loan as current liabilities.

Question 18

The Summit Bank loan is split $8 000 current and $52 000 non-current; the Mortgage (20 years) is non-current. Total Assets = $18 000 + $182 000 = **$200 000**; Total Liabilities = $20 000 + $100 000 = $120 000; with Capital of $80 000 the report balances at $200 000.

Balance Sheet of Meridian Engineering as at 30 June 2025

	$	$
Current Assets		
Bank	6 000	
Accounts Receivable	8 000	
Prepaid insurance	1 000	
Supplies	3 000	18 000
Non-Current Assets		
Plant & equipment	60 000	
Motor vehicles	30 000	
Land & buildings	92 000	182 000
Total Assets		200 000
Current Liabilities		
Accounts Payable	12 000	
Loan – Summit Bank (current portion)	8 000	20 000
Non-Current Liabilities		
Loan – Summit Bank	52 000	
Mortgage – Summit Bank	48 000	100 000
Total Liabilities		120 000
Owner's Equity		
Capital		80 000
Total Liabilities and Owner's Equity		200 000

Total Assets are **$200 000**. Of this, external parties (Accounts Payable, the loan and the mortgage) financed $120 000 — 60% of the assets — and the owner financed $80 000, or 40%. The business is more than half financed by outsiders, with the bulk of that debt being long-term (the $100 000 of non-current liabilities), which the large base of non-current assets ($182 000, chiefly Land & buildings) helps to support.

Chapter 2 The accounting equation — 2C Transactions, the equation and financial indicators

Theory

Every business is built on the **accounting equation**:

$$\text{Assets} = \text{Liabilities} + \text{Owner's equity}$$

An **asset** is a present economic resource controlled by the business as a result of past events, with the potential to produce future economic benefits; a **liability** is a present obligation of the business to transfer an economic resource as a result of past events; and **owner's equity** is the **residual** interest in the assets of the business after deducting all its liabilities (**Capital** and profit build it up; **Drawings** and losses reduce it). The **Balance Sheet** reports these three elements at a single point in time, and — because it is only a rearrangement of the equation — **it must balance**: total assets always equal total liabilities plus owner's equity.

The twofold effect of a transaction. A **transaction** is an event that changes the financial position of the business. Every transaction has an effect on **at least two** items in the accounting equation. This is not an arbitrary rule — it follows directly from the equation. If a single transaction changed only **one** item, the two sides would no longer be equal, which is impossible for a true statement of position. So a transaction must either:

- **change two items on opposite sides** of the equation by the same amount (for example, an asset and a liability both rise), or
- **change two items on the same side** in opposite directions (for example, one asset rises while another asset falls), leaving each side's total unchanged.

Formally, for the equation to stay balanced, the **change** in each element after a transaction must satisfy:

$$\Delta\,\text{Assets} = \Delta\,\text{Liabilities} + \Delta\,\text{Owner's equity}$$

where **Δ** means "the change in". A neat way to see the twofold effect is a small **effect-on-the-equation** table with a column for each element: an increase is written as a **+** amount and a decrease as a **−** amount. If the row satisfies ΔA = ΔL + ΔOE, the equation still balances. Revenues and expenses reach the equation **through owner's equity**: earning cash revenue increases owner's equity (through profit), and paying a cash expense decreases it; contributing **Capital** increases owner's equity, while **Drawings** decrease it.

Worked model of the twofold effect. *Rowan Bright* starts a gardening service. First the owner contributes **$50 000** cash; then the business buys a **van for $30 000**, paying $10 000 cash and borrowing the remaining $20 000 from Meridian Bank:

Transaction	Assets $	Liabilities $	Owner's equity $
Owner contributes cash — Bank +, Capital +	+50 000		+50 000
Buys van — Van +, Bank −, Loan +	+30 000 − 10 000 = +20 000	+20 000	

The first transaction changes two items on **opposite sides** (ΔA +$50 000 = ΔL $0 + ΔOE +$50 000); the second changes **three** items, proving that "twofold" is a **minimum**, not a maximum (ΔA +$20 000 = ΔL +$20 000 + ΔOE $0). After both, the business holds **Bank $40 000** and a **Van $30 000** (assets $70 000), owes a **Loan $20 000**, and has **Capital $50 000**: **A = L + OE**, $70 000 = $20 000 + $50 000.

Reading the Balance Sheet — two financial indicators. A Balance Sheet is only useful if it is **interpreted**. Two introductory **financial indicators** are calculated directly from the classified Balance Sheet and let the owner (and a lender) judge the business's **liquidity** and **financial stability**.

The **Working Capital Ratio (WCR)** measures **liquidity** — whether the business holds enough current assets to meet its short-term debts as they fall due:

Working Capital Ratio = current assets ÷ current liabilities

It is expressed as a ratio to **1** (for example, **2.0 : 1**). A WCR of **2.0 : 1** means the business holds **$2 of current assets for every $1 of current liabilities**. A ratio **above 1 : 1** means current assets exceed current liabilities, so the business can cover its short-term obligations; a ratio **below 1 : 1** signals a **liquidity problem**. A benchmark of about **2 : 1** is often regarded as comfortable, though a very high ratio can suggest cash or receivables sitting idle rather than being put to work.

The **Debt Ratio** measures **financial stability** — the proportion of the business's assets that is financed by **outside parties** (liabilities) rather than by the owner:

Debt Ratio = (total liabilities ÷ total assets) × 100

It is expressed as a **percentage**. A Debt Ratio of **40%** means **40 cents in every dollar of assets is financed by liabilities**, and the remaining 60 cents by the owner. A **higher** Debt Ratio means **greater reliance on borrowed funds** — higher **risk**, because interest must be paid and the debt repaid whether or not the business trades well, but also the chance of a higher return if borrowed funds are used productively. A **lower** Debt Ratio means the business is financed mainly by the owner — lower risk, but potentially a lower return on the owner's investment.

Worked model of the indicators. *Harlow Home Care* reports this Balance Sheet as at 30 June 2025:

	$	$
Current Assets		
Bank	8 000	
Accounts Receivable	6 000	14 000
Non-Current Assets		
Equipment	30 000	
Delivery vehicle	26 000	56 000
Total Assets		70 000
Current Liabilities		
Accounts Payable	4 000	
GST Clearing	3 000	7 000
Non-Current Liabilities		
Loan – Anchor Bank		21 000
Total Liabilities		28 000
Owner's Equity		
Capital		42 000
Total Liabilities and Owner's Equity		70 000

Working Capital Ratio = current assets $14 000 ÷ current liabilities $7 000 = **2.0 : 1** — the business holds $2 of current assets for every $1 of current liabilities, a comfortable short-term position. Debt Ratio = (total liabilities $28 000 ÷ total assets $70 000) × 100 = **40%** — 40 cents of every asset dollar is financed externally, so the business relies more on the owner than on outside funds and carries a relatively low level of risk.

Ethical considerations. The Balance Sheet and its indicators are read by outsiders — most importantly a **lender** or a prospective **buyer** of the business — so the owner has an ethical duty to present the position **completely, free from material error and without bias — a faithful representation**. It would be misleading to **"window dress"** the reports so that they show a more flattering picture than the true position: for example, **delaying the recording of a supplier's invoice** until after balance day so that current liabilities look smaller and the Working Capital Ratio looks stronger, or **omitting a liability** so the Debt Ratio appears lower.

A third tactic — timing a short-term loan drawdown so that a swollen Bank balance sits on the report on balance day — is just as dishonest, but it is worth seeing that it does **not** improve either indicator. It raises current assets and current liabilities by the **same** amount, which pulls the Working Capital Ratio **toward 1 : 1** (so a business already above 1 : 1 reports a *weaker* ratio), and it raises total assets and total liabilities by the same amount, which **raises** the

Debt Ratio. Only the raw cash figure is inflated. Such choices give a lender a distorted view of the business's ability to repay, may lead to funds being advanced that the business cannot service, and damage the owner's reputation when the true position emerges. Ethical reporting records every asset and liability **completely and truthfully**, and lets the reader judge the business on its real position.

Worked examples (scaffolded)

Example 1 — analysing the twofold effect of five transactions

Delwood Dog Grooming, owned by K. Delwood, began July 2025 with no assets or liabilities. Analyse the effect of each transaction on the accounting equation and confirm the equation balances.

- 1 Jul — the owner contributed $28 000 cash.
- 4 Jul — bought grooming equipment for $7 000 cash.
- 9 Jul — paid $1 200 cash for rent.
- 14 Jul — received $2 400 cash for grooming services.
- 20 Jul — borrowed $6 000 cash from Marina Bank.

Working	Comment
1 Jul: Bank (asset) increases $28 000; Capital (owner's equity) increases $28 000. ΔA +$28 000 = ΔL $0 + ΔOE +$28 000.	An owner's cash contribution raises an **asset** and **owner's equity** — two items on opposite sides.
4 Jul: Equipment (asset) increases $7 000; Bank (asset) decreases $7 000. ΔA = +$7 000 − $7 000 = $0.	Buying an asset for cash swaps one asset for another — two items on the **same side**, so total assets are unchanged.
9 Jul: Bank (asset) decreases $1 200; owner's equity decreases $1 200 (the rent expense reduces profit). ΔA −$1 200 = ΔL $0 + ΔOE −$1 200.	A **cash expense** reduces an asset and reduces owner's equity through profit.
14 Jul: Bank (asset) increases $2 400; owner's equity increases $2 400 (the fee is revenue). ΔA +$2 400 = ΔL $0 + ΔOE +$2 400.	**Cash revenue** raises an asset and raises owner's equity through profit.
20 Jul: Bank (asset) increases $6 000; Loan – Marina Bank (liability) increases $6 000. ΔA +$6 000 = ΔL +$6 000 + ΔOE $0.	A **loan** raises an asset and a liability — two items on opposite sides.

The effect on the equation, transaction by transaction:

Transaction	Assets $	Liabilities $	Owner's equity $
1 Jul — Bank +, Capital +	+28 000		+28 000
4 Jul — Equipment +, Bank −	+7 000 − 7 000 = 0		
9 Jul — Bank −, Rent expense	−1 200		−1 200
14 Jul — Bank +, revenue	+2 400		+2 400
20 Jul — Bank +, Loan +	+6 000	+6 000	

After the five transactions: **Bank $28 200** and **Equipment $7 000** give total **assets $35 200**; the **Loan – Marina Bank is $6 000**; **owner's equity is $29 200** (Capital $28 000 − rent $1 200 + revenue $2 400). **A = L + OE:** $35 200 = $6 000 + $29 200 — the equation balances.

Example 2 — calculating and interpreting the Working Capital Ratio and Debt Ratio

Castleford Cleaning reports the Balance Sheet below as at 30 June 2025. Calculate the Working Capital Ratio and the Debt Ratio, and interpret each.

	$	$
Current Assets		
Bank	4 500	
Accounts Receivable	7 500	12 000
Non-Current Assets		
Office equipment	18 000	
Motor vehicle	30 000	48 000
Total Assets		60 000
Current Liabilities		
Accounts Payable	5 000	
GST Clearing	3 000	8 000
Non-Current Liabilities		
Loan – Beacon Bank		22 000
Total Liabilities		30 000
Owner's Equity		
Capital		30 000
Total Liabilities and Owner's Equity		60 000

Working	Comment
Identify the **current** items only for the WCR: current assets = Bank $4 500 + Accounts Receivable $7 500 = **$12 000**; current liabilities = Accounts Payable $5 000 + GST Clearing $3 000 = **$8 000**.	The Working Capital Ratio uses **current** assets and **current** liabilities — the non-current loan is excluded.
Working Capital Ratio = $12 000 ÷ $8 000 = **1.5 : 1**.	The business holds $1.50 of current assets for every $1 of current liabilities.
Interpret: current assets exceed current liabilities, so the business can meet its short-term debts, but the buffer is thinner than the 2 : 1 benchmark.	Above 1 : 1 is solvent in the short term; 1.5 : 1 is adequate but leaves less margin for error.
Identify **total** figures for the Debt Ratio: total liabilities = **$30 000**; total assets = **$60 000**.	The Debt Ratio uses *all* liabilities and *all* assets, current and non-current.
Debt Ratio = ($30 000 ÷ $60 000) × 100 = **50%**.	Half of every asset dollar is financed by outside parties.
Interpret: the business is financed **equally** by the owner and by liabilities — a moderate level of risk; interest and repayments must be met, but the reliance on debt is not extreme.	A higher Debt Ratio means more risk and (potentially) more return; 50% is a balanced position.

∴ *Castleford Cleaning* is solvent in the short term (WCR **1.5 : 1**) and moderately geared (Debt Ratio **50%**).

Worked examples (unscaffolded)

Example 3 — non-cash and asset-for-liability transactions

Sinclair Surveying records three transactions. First, the owner contributed a **vehicle valued at $22 000** to the business (no cash changed hands). Second, the business repaid **$5 000** of its bank loan in cash. Third, the owner took a **printer (a business asset) valued at $600** home for private use. Analyse the effect of each on the accounting equation.

The contribution increases the asset Vehicle by \$22 000 and increases owner's equity (Capital) by \$22 000: ΔA +\$22 000 = ΔL \$0 + ΔOE +\$22 000 — a **non-cash** contribution, yet an asset and owner's equity still rise together. The loan repayment decreases the asset Bank by \$5 000 and decreases the liability Loan by \$5 000: ΔA −\$5 000 = ΔL −\$5 000 + ΔOE \$0 — an asset and a liability fall together. The drawing of the printer decreases the asset Printer by \$600 and decreases owner's equity (Drawings) by \$600: ΔA −\$600 = ΔL \$0 + ΔOE −\$600 — like a cash drawing, but the asset withdrawn is not cash.

∴ each transaction changes exactly two items and keeps the accounting equation in balance.

Example 4 — how a transaction changes the indicators

Pinehill Plumbing reports this Balance Sheet as at 30 June 2025. The business then **repays \$12 000 of its loan in cash**. Show the effect of that transaction on the accounting equation, and recalculate the Working Capital Ratio and the Debt Ratio.

	\$	\$
Current Assets		
Bank	16 000	
Accounts Receivable	8 000	24 000
Non-Current Assets		
Equipment		36 000
Total Assets		60 000
Current Liabilities		
Accounts Payable	8 000	
GST Clearing	4 000	12 000
Non-Current Liabilities		
Loan – Redgum Bank		18 000
Total Liabilities		30 000
Owner's Equity		
Capital		30 000
Total Liabilities and Owner's Equity		60 000

Before: Working Capital Ratio = \$24 000 ÷ \$12 000 = **2.0 : 1**; Debt Ratio = (\$30 000 ÷ \$60 000) × 100 = **50%**.

The repayment decreases the asset Bank by \$12 000 and decreases the liability Loan by \$12 000: ΔA −\$12 000 = ΔL −\$12 000 + ΔOE \$0 — an asset and a liability fall together, so the equation stays in balance. Because Bank is a **current asset** and the loan is a **non-current liability**, current assets fall to \$12 000 while current liabilities are unchanged at \$12 000; total assets fall to \$48 000 and total liabilities to \$18 000.

After: Working Capital Ratio = \$12 000 ÷ \$12 000 = **1.0 : 1**; Debt Ratio = (\$18 000 ÷ \$48 000) × 100 = **37.5%**.

∴ using cash to repay long-term debt **improves the Debt Ratio** (37.5%, less reliance on outside funds) but **worsens the Working Capital Ratio** (down to 1.0 : 1, the short-term buffer wiped out) — a clear example of how the two indicators can move in **opposite directions** after a single transaction.

Practice questions — scaffolded

Question 1

On 1 March 2025, F. Fernbrook started a picture-framing business by contributing \$32 000 cash. On 5 March the business bought framing equipment for \$9 000 cash.

a. For each transaction, state the two items that change and by how much.
b. Complete an effect-on-the-equation table (columns Assets / Liabilities / Owner's equity) for each transaction.

c. Confirm the accounting equation balances after both transactions, showing A = L + OE.

Question 2

Marlowe Music Tuition had **Bank $14 000** and **Capital $14 000** on 1 April 2025. During April:

- 3 Apr — paid $800 cash for rent.
- 8 Apr — received $3 500 cash for lessons.
- 15 Apr — borrowed $10 000 cash from Delta Bank.
- 22 Apr — the owner withdrew $1 200 cash for private use.

a. State the two items that change in each transaction and the direction of each change.

b. Complete an effect-on-the-equation table for each transaction.

c. Confirm the accounting equation balances after all four transactions, and state the closing totals for Assets, Liabilities and Owner's equity.

Question 3

Oakhaven Optometry began 1 May 2025 with **Bank $20 000**, **Equipment $40 000**, a **Loan – Summit Bank $24 000** and **Capital $36 000**. During May:

- 4 May — bought diagnostic equipment for $12 000, paying $4 000 cash and borrowing the remaining $8 000 from Summit Bank.
- 12 May — the owner withdrew $2 000 cash for private use.
- 20 May — the owner contributed a computer valued at $3 000 to the business.

a. State the items that change in each transaction and by how much.

b. Complete an effect-on-the-equation table for each transaction.

c. Confirm the accounting equation balances, and state the closing totals for Assets, Liabilities and Owner's equity.

Question 4

Sunridge Signs reports the Balance Sheet below as at 30 June 2025.

	$	$
Current Assets		
Bank	6 000	
Accounts Receivable	9 000	15 000
Non-Current Assets		
Equipment	25 000	
Motor vehicle	20 000	45 000
Total Assets		60 000
Current Liabilities		
Accounts Payable	7 000	
GST Clearing	3 000	10 000
Non-Current Liabilities		
Loan – Ironbark Bank		20 000
Total Liabilities		30 000
Owner's Equity		
Capital		30 000
Total Liabilities and Owner's Equity		60 000

a. Identify the total current assets and total current liabilities.

b. Calculate the Working Capital Ratio.

c. Interpret the ratio in one sentence, stating whether the business can meet its short-term debts.

Question 5

Brookvale Bookkeeping reports total assets of **$80 000**, total liabilities of **$20 000** and owner's equity of **$60 000** as at 30 June 2025.

a. Calculate the Debt Ratio.

b. State the proportion of the business's assets financed by the owner.

c. Explain in one sentence what a **lower** Debt Ratio tells a lender about the risk of lending to this business.

Question 6

Glenora Gardening reports the Balance Sheet below as at 30 June 2025.

	$	$
Current Assets		
Bank	8 000	
Accounts Receivable	12 000	20 000
Non-Current Assets		
Equipment	30 000	
Vehicles	50 000	80 000
Total Assets		100 000
Current Liabilities		
Accounts Payable	5 000	
GST Clearing	3 000	8 000
Non-Current Liabilities		
Loan – Summit Bank		37 000
Total Liabilities		45 000
Owner's Equity		
Capital		55 000
Total Liabilities and Owner's Equity		100 000

a. Calculate the Working Capital Ratio.

b. Calculate the Debt Ratio.

c. Interpret both indicators, commenting on the business's short-term liquidity and its reliance on outside funds.

Practice questions — unscaffolded

Question 7

On 1 October 2025, W. Whitby contributed $45 000 cash to start a web-services business. Analyse the effect of this transaction on the accounting equation, state the items that change and by how much, and confirm the equation balances.

Question 8

Ashgrove Accounting bought a laptop for $2 800 cash. Analyse the effect of this transaction on the accounting equation.

Question 9

Balfour Building Inspections paid $1 350 cash for insurance. Analyse the effect of this transaction on the accounting equation.

Question 10

Carrington Consulting received $5 200 cash for fees. Analyse the effect of this transaction on the accounting equation.

Question 11

Denholm Drafting borrowed $18 000 cash from Coastline Bank. Analyse the effect of this transaction on the accounting equation.

Question 12

Everett Electrical Testing began 1 November 2025 with **Bank $12 000**, **Equipment $18 000**, a **Loan – Pinnacle Bank $9 000** and **Capital $21 000**. During November:

- 4 Nov — the owner contributed a further $6 000 cash.
- 10 Nov — bought a testing rig for $4 500 cash.
- 17 Nov — received $3 300 cash for services.
- 24 Nov — repaid $2 000 of the loan in cash.

Analyse the effect of each transaction on the accounting equation, confirm the equation balances after each, and state the closing totals for Assets, Liabilities and Owner's equity.

Question 13

Tamworth Tutoring reports current assets of **$9 000** and current liabilities of **$12 000** as at 30 June 2025. Calculate the Working Capital Ratio and interpret it, stating clearly what the ratio reveals about the business's ability to meet its short-term debts.

Question 14

Rowena Removals reports total liabilities of **$63 000** and total assets of **$90 000** as at 30 June 2025. Calculate the Debt Ratio and interpret it, commenting on the level of risk the business carries.

Question 15

Two service businesses each report total assets of $80 000 as at 30 June 2025:

- *Aspen Accounting* — current assets $24 000, current liabilities $8 000, total liabilities $16 000.
- *Birch Bookkeeping* — current assets $15 000, current liabilities $15 000, total liabilities $48 000.

Calculate the Working Capital Ratio and the Debt Ratio for each business, and state which business is **more liquid** and which carries the **higher risk**, justifying your choice.

Question 16

Halden Hire reports current assets of $18 000, current liabilities of $9 000, total assets of $72 000 and total liabilities of $36 000 as at 30 June 2025. The business then **buys equipment for $9 000 cash**.

a. Analyse the effect of the purchase on the accounting equation.
b. Recalculate the Working Capital Ratio and the Debt Ratio after the purchase.
c. Explain why this transaction changes the Working Capital Ratio but leaves the Debt Ratio unchanged.

Question 17

Answer each part using the indicator formulas.

a. A business has current liabilities of $14 000 and a Working Capital Ratio of 1.5 : 1. Calculate its current assets.

b. A business has total assets of $90 000 and a Debt Ratio of 40%. Calculate its total liabilities and its owner's equity.

Question 18

Willowbank Cleaning has applied to Anchor Bank for a loan. A week before balance day the owner, wanting the Balance Sheet to look as strong as possible, is considering two actions: **(i)** holding back the recording of a $4 000 supplier invoice already received until the day *after* balance day, and **(ii)** drawing down a $10 000 short-term loan on the last day of the period and repaying it two days later, purely to boost the cash shown on the Balance Sheet. Discuss the effect each action would have on the Working Capital Ratio and the Debt Ratio, and evaluate the owner's conduct with reference to a relevant **ethical consideration**.

Answers

1.
    a. Bank +$32 000 & Capital +$32 000; then Framing equipment +$9 000 & Bank −$9 000. c. A $32 000 = L $0 + OE $32 000
2.
    c. Closing: A $25 500 = L $10 000 + OE $15 500
3.
    c. Closing: A $69 000 = L $32 000 + OE $37 000
4.
    a. Current assets $15 000; current liabilities $10 000. b. **1.5 : 1** c. Can meet short-term debts (above 1 : 1), but a thinner buffer than 2 : 1.
5.
    a. **25%** b. 75% financed by the owner c. A lower Debt Ratio means less reliance on borrowing and lower risk for the lender.
6.
    a. **2.5 : 1** b. **45%**
7. Bank (asset) +$45 000; Capital (OE) +$45 000. ΔA +$45 000 = ΔL $0 + ΔOE +$45 000
8. Laptop (asset) +$2 800; Bank (asset) −$2 800. ΔA = $0; equation unchanged
9. Bank (asset) −$1 350; OE −$1 350 (expense). ΔA −$1 350 = ΔL $0 + ΔOE −$1 350
10. Bank (asset) +$5 200; OE +$5 200 (revenue). ΔA +$5 200 = ΔL $0 + ΔOE +$5 200
11. Bank (asset) +$18 000; Loan (liability) +$18 000. ΔA +$18 000 = ΔL +$18 000 + ΔOE $0
12. Closing: A $37 300 = L $7 000 + OE $30 300
13. **0.75 : 1** — current assets are less than current liabilities, so the business cannot cover its short-term debts from current assets (a liquidity problem).
14. **70%** — a high proportion of assets is financed by outside parties, so the business carries a high level of risk.
15. Aspen: WCR **3.0 : 1**, Debt **20%**; Birch: WCR **1.0 : 1**, Debt **60%**. Aspen is more liquid; Birch carries the higher risk.
16.
    b. WCR **1.0 : 1**; Debt Ratio **50%** (unchanged).
17.
    a. Current assets **$21 000** b. Total liabilities **$36 000**; owner's equity **$54 000**
18. See solutions — (i) overstates the WCR and understates the Debt Ratio; (ii) pulls the WCR toward 1 : 1 and **raises** the Debt Ratio, so both indicators worsen

Fully-worked solutions

Question 1

a. **1 Mar:** Bank (asset) increases $32 000; Capital (owner's equity) increases $32 000. **5 Mar:** Framing equipment (asset) increases $9 000; Bank (asset) decreases $9 000.

Transaction	Assets $	Liabilities $	Owner's equity $
1 Mar — Bank +, Capital +	+32 000		+32 000
5 Mar — Framing equipment +, Bank −	+9 000 − 9 000 = 0		

c. After both transactions: Bank $23 000 + Framing equipment $9 000 = **assets $32 000**; **liabilities $0**; **owner's equity $32 000**. **A = L + OE:** $32 000 = $0 + $32 000.

Question 2

a. **3 Apr:** Bank −$800 & owner’s equity −$800 (rent expense). **8 Apr:** Bank +$3 500 & owner’s equity +$3 500 (lesson revenue). **15 Apr:** Bank +$10 000 & Loan +$10 000. **22 Apr:** Bank −$1 200 & owner’s equity −$1 200 (Drawings).

Transaction	Assets $	Liabilities $	Owner’s equity $
3 Apr — Bank −, Rent expense	−800		−800
8 Apr — Bank +, revenue	+3 500		+3 500
15 Apr — Bank +, Loan +	+10 000	+10 000	
22 Apr — Bank −, Drawings	−1 200		−1 200

c. Bank = $14 000 − $800 + $3 500 + $10 000 − $1 200 = $25 500, so **assets $25 500**; **liabilities $10 000** (Loan – Delta Bank); owner’s equity = $14 000 − $800 + $3 500 − $1 200 = **$15 500**. **A = L + OE:** $25 500 = $10 000 + $15 500.

Question 3

a. **4 May:** Diagnostic equipment (asset) +$12 000; Bank (asset) −$4 000; Loan (liability) +$8 000. **12 May:** Bank (asset) −$2 000; owner’s equity −$2 000 (Drawings). **20 May:** Computer (asset) +$3 000; Capital (owner’s equity) +$3 000.

Transaction	Assets $	Liabilities $	Owner’s equity $
4 May — Equipment +, Bank −, Loan +	+12 000 − 4 000 = +8 000	+8 000	
12 May — Bank −, Drawings	−2 000		−2 000
20 May — Computer +, Capital +	+3 000		+3 000

c. Bank = $20 000 − $4 000 − $2 000 = $14 000; Equipment = $40 000 + $12 000 = $52 000; Computer $3 000. Assets = $14 000 + $52 000 + $3 000 = **$69 000**. Loan = $24 000 + $8 000 = **$32 000**. Owner’s equity = Capital $36 000 − Drawings $2 000 + contribution $3 000 = **$37 000**. **A = L + OE:** $69 000 = $32 000 + $37 000.

Question 4

a. Current assets = Bank $6 000 + Accounts Receivable $9 000 = **$15 000**; current liabilities = Accounts Payable $7 000 + GST Clearing $3 000 = **$10 000**.

b. Working Capital Ratio = current assets $15 000 ÷ current liabilities $10 000 = **1.5 : 1**.

c. The business holds $1.50 of current assets for every $1 of current liabilities, so it **can meet its short-term debts** from current assets — but the buffer is smaller than the 2 : 1 benchmark, leaving less margin if receipts are slow.

Question 5

a. Debt Ratio = (total liabilities $20 000 ÷ total assets $80 000) × 100 = **25%**.

b. If 25% of assets are financed by liabilities, then **75%** are financed by the owner (owner’s equity $60 000 ÷ total assets $80 000).

c. A **lower** Debt Ratio means the business relies less on borrowed funds and more on the owner’s own investment, so there is **less risk** that it will be unable to meet interest and repayments — a safer proposition for the lender.

Question 6

a. Current assets = Bank \$8 000 + Accounts Receivable \$12 000 = \$20 000; current liabilities = Accounts Payable \$5 000 + GST Clearing \$3 000 = \$8 000. Working Capital Ratio = \$20 000 ÷ \$8 000 = **2.5 : 1**.

b. Debt Ratio = (total liabilities \$45 000 ÷ total assets \$100 000) × 100 = **45%**.

c. A Working Capital Ratio of **2.5 : 1** is comfortably above the 2 : 1 benchmark — the business holds \$2.50 of current assets for every \$1 of current liabilities, so it can readily meet its short-term debts. A Debt Ratio of **45%** means outside parties finance 45 cents of every asset dollar and the owner finances the remaining 55 cents — a moderate, slightly owner-weighted reliance on debt, and therefore a moderate level of risk.

Question 7

Bank (asset) increases \$45 000; Capital (owner's equity) increases \$45 000. **ΔA = ΔL + ΔOE:** +\$45 000 = \$0 + \$45 000 — the equation balances. Two items change, an asset and owner's equity, on opposite sides.

Question 8

Laptop (asset) increases \$2 800; Bank (asset) decreases \$2 800. The two changes are on the **same side**, so **ΔA = +\$2 800 − \$2 800 = \$0**; liabilities and owner's equity are unchanged. Only the composition of assets changes — cash is exchanged for a non-current asset.

Question 9

Bank (asset) decreases \$1 350; owner's equity decreases \$1 350 (the insurance is an expense that reduces profit). **ΔA = ΔL + ΔOE:** −\$1 350 = \$0 + (−\$1 350) — the equation balances.

Question 10

Bank (asset) increases \$5 200; owner's equity increases \$5 200 (the fee is revenue that adds to profit). **ΔA = ΔL + ΔOE:** +\$5 200 = \$0 + \$5 200 — the equation balances.

Question 11

Bank (asset) increases \$18 000; Loan – Coastline Bank (liability) increases \$18 000. **ΔA = ΔL + ΔOE:** +\$18 000 = + \$18 000 + \$0 — the equation balances. An asset and a liability rise together, on opposite sides.

Question 12

Transaction	Assets \$	Liabilities \$	Owner's equity \$
4 Nov — Bank +, Capital +	+6 000		+6 000
10 Nov — Testing rig +, Bank −	+4 500 − 4 500 = 0		
17 Nov — Bank +, revenue	+3 300		+3 300
24 Nov — Bank −, Loan −	−2 000	−2 000	

Each transaction keeps ΔA = ΔL + ΔOE, so the equation balances after each. Closing balances:

- Bank = \$12 000 + \$6 000 − \$4 500 + \$3 300 − \$2 000 = \$14 800.
- Assets = Bank \$14 800 + Equipment (\$18 000 + \$4 500) \$22 500 = **\$37 300**.
- Liabilities = Loan – Pinnacle Bank = \$9 000 − \$2 000 = **\$7 000**.
- Owner's equity = Capital \$21 000 + \$6 000 (contribution) + \$3 300 (revenue) = **\$30 300**.

A = L + OE: \$37 300 = \$7 000 + \$30 300.

Question 13

Working Capital Ratio = current assets \$9 000 ÷ current liabilities \$12 000 = **0.75 : 1**. The business holds only 75 cents of current assets for every \$1 of current liabilities — its current assets are **less** than its current liabilities. Because the ratio is **below 1 : 1**, the business **cannot cover its short-term debts** from its current assets as they fall due; it has a **liquidity problem** and may need to raise more cash, slow its payments or arrange additional short-term finance.

Question 14

Debt Ratio = (total liabilities \$63 000 ÷ total assets \$90 000) × 100 = **70%**. Seventy cents of every asset dollar is financed by outside parties, and only 30 cents by the owner. This is a **high** Debt Ratio, so the business carries a **high level of risk**: a large share of its assets is funded by debt that must be serviced with interest and repaid regardless of how trading goes, and a downturn could leave the business unable to meet those commitments. The high gearing does, however, offer the owner the chance of a higher return if the borrowed funds are used productively.

Question 15

Aspen Accounting: Working Capital Ratio = \$24 000 ÷ \$8 000 = **3.0 : 1**; Debt Ratio = (\$16 000 ÷ \$80 000) × 100 = **20%**.

Birch Bookkeeping: Working Capital Ratio = \$15 000 ÷ \$15 000 = **1.0 : 1**; Debt Ratio = (\$48 000 ÷ \$80 000) × 100 = **60%**.

Aspen is the more liquid business: at 3.0 : 1 it holds \$3 of current assets for every \$1 of current liabilities, against Birch's 1.0 : 1, where current assets only just equal current liabilities. **Birch carries the higher risk:** its Debt Ratio of 60% means outside parties finance 60 cents of every asset dollar (against Aspen's 20 cents), so Birch depends far more heavily on borrowed funds that must be serviced and repaid.

Question 16

a. Equipment (asset) increases \$9 000; Bank (asset) decreases \$9 000. The changes are on the **same side**, so **ΔA = +\$9 000 − \$9 000 = \$0**; liabilities and owner's equity are unchanged.

b. Current assets fall to \$18 000 − \$9 000 = \$9 000, while current liabilities stay at \$9 000, so the Working Capital Ratio = \$9 000 ÷ \$9 000 = **1.0 : 1** (down from 2.0 : 1). Total assets are unchanged at \$72 000 (one asset was swapped for another) and total liabilities are unchanged at \$36 000, so the Debt Ratio = (\$36 000 ÷ \$72 000) × 100 = **50%** (unchanged).

c. The purchase moved value from a **current asset** (Bank) to a **non-current asset** (Equipment), so current assets fell while current liabilities did not — the Working Capital Ratio, which uses only current items, therefore falls. But **total** assets and **total** liabilities were both unchanged (the transaction only altered the *composition* of assets), so the Debt Ratio, which uses the totals, is unaffected.

Question 17

a. Working Capital Ratio = current assets ÷ current liabilities, so current assets = Working Capital Ratio × current liabilities = 1.5 × \$14 000 = **\$21 000**.

b. Debt Ratio = (total liabilities ÷ total assets) × 100, so total liabilities = 40% × \$90 000 = 0.40 × \$90 000 = **\$36 000**. Owner's equity = total assets − total liabilities = \$90 000 − \$36 000 = **\$54 000**.

Question 18

Action (i) — holding back the \$4 000 invoice. The supplier invoice is a liability (an account payable) for materials already supplied, so it exists at balance day. Omitting it would understate current liabilities by \$4 000 while current assets stay the same, so the Working Capital Ratio would be reported as **higher** (a smaller denominator) and the Debt Ratio as **lower** (smaller total liabilities against unchanged total assets) than the true position. This action does flatter both indicators — which is exactly what makes it misleading.

Action (ii) — the overnight loan. Drawing \$10 000 on the last day raises a current asset (Bank) and a current liability (the short-term loan) by the **same \$10 000**, so it does not do what the owner is hoping. Adding an equal amount to both the numerator and the denominator pulls the Working Capital Ratio **toward 1 : 1**, so a business already above 1 : 1 reports a **lower** ratio — a business with current assets \$20 000 and current liabilities \$10 000 (2.0 : 1) would report \$30 000 ÷ \$20 000 = **1.5 : 1**. The Debt Ratio **rises**, because adding the same amount to total liabilities and to total assets moves the fraction closer to 100% whenever liabilities are less than assets — that is, whenever the owner has any equity at all: on total liabilities \$28 000 and total assets \$70 000 (40%), the ratio would climb to (\$38 000 ÷ \$80

000) × 100 = **47.5%**. The tactic inflates only the raw **Bank** figure; on the two indicators Anchor Bank will actually calculate, the business looks **less liquid and more indebted**. It is therefore both dishonest and self-defeating.

Both actions breach **faithful representation**: the information reported should be **complete, free from material error and neutral (without bias)**, presenting the business's real position rather than a flattering snapshot. The owner also has a duty of honesty toward Anchor Bank, which will rely on this Balance Sheet to decide whether — and on what terms — to lend. Misstating the report, whether by overstating the indicators or by parading cash the business does not really hold, could induce the bank to advance funds the business cannot actually service, exposing the lender to loss and the owner to the collapse of trust (and possible legal consequences) once the true position emerges. The ethical course is to record **every** liability in the period it arises and to report only genuine, ongoing cash balances, so that the indicators reflect the position on which the business should properly be judged.