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Level 2 Accounting, 2014

91174 Demonstrate understanding of accounting concepts for an entity that operates accounting subsystems

2.00 pm Wednesday 26 November 2014
Credits: Four

Achievement	Achievement with Merit	Achievement with Excellence
Demonstrate understanding of accounting concepts for an entity that operates accounting subsystems.	Demonstrate in-depth understanding of accounting concepts for an entity that operates accounting subsystems.	Demonstrate comprehensive understanding of accounting concepts for an entity that operates accounting subsystems.

Check that the National Student Number (NSN) on your admission slip is the same as the number at the top of this page.

You should attempt ALL the questions in this booklet.

If you need more room for any answer, use the extra space provided at the back of this booklet.

Check that this booklet has pages 2–11 in the correct order and that none of these pages is blank.

YOU MUST HAND THIS BOOKLET TO THE SUPERVISOR AT THE END OF THE EXAMINATION.

Not Achieved

TOTAL 5

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QUESTION ONE

On 10 April 2013, Jessica purchased a small business called *Fancy Pants*, a fancy dress and costume hire shop. Jessica made this decision after careful consideration of the financial statements and consultation with her bank manager.

Below is an extract of the Statement of Financial Position for *Fancy Pants* used by Jessica in her decision to buy the business.

Fancy Pants **Statement of Financial Position (extract) as at 31 March 2013**	
	$NZ
Assets	
Accounts receivable	1600
Prepayments	250
Property, plant and equipment (Note)	37300
Goodwill	8000
Total assets	**47150**
Liabilities	
Accounts payable	2100
Income in advance (hire fees)	90
Bank loan	7000
Total liabilities	**9190**

Note: Property, plant and equipment

As at 31 March 2013	Costumes	Office computer	Shop fittings	Total
	$NZ	$NZ	$NZ	$NZ
Cost	26000	5400	22000	53400
Accumulated depreciation	7300	2200	6600	16100
Carrying amount	18700	3200	15400	37300

The student has identified a purpose of the statement of financial position and described understandability

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(a) With reference to the extract on the previous page, justify how the Statement of Financial Position was useful to Jessica when she made her decision to purchase the business *Fancy Pants*.
Include in your answer:

- the **purpose** of *Fancy Pants*' Statement of Financial Position
- an explanation of how Jessica may have used information in *Fancy Pants*' Statement of Financial Position when making her decision
- an explanation of how the qualitative characteristic of **understandability** was important to Jessica's use of *Fancy Pants*' Statement of Financial Position in her decision
- a limitation of *Fancy Pants*' Statement of Financial Position and the importance of Jessica being aware of the limitation when making her decision.

- The purpose of the Statement of Financial Position is to inform users of the ~~wa~~ desired ~~ID~~ financial information of the business (Fancy Pants). This helps users make financial decisions. 0
- Jessica would have used the information given to her by the previous owner in the Fancy Pants' Statement of Financial Position to see ~~A~~ things such as assets and liabilities to influence her decision on buying the business. 0
- The qualitive characteristic of "Understandability" was important to Jessica's use of Fancy Pants' Statement of Financial Position in her decision because the information given was clear and ~~precis~~ precise, Free from error and bias and overall easy for Jessica to understand the Statement of Financial Position. 1

At the end of the financial year (31 March 2013), *Fancy Pants* had received $90 from a customer for a pre-ordered costume that was to be hired in May 2013.

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(b) Using the **accrual basis**, fully explain **how** and **why** the hire fee of $90 received in advance was reported in both the Statement of Financial Position and the Income Statement for *Fancy Pants*.

The accounting concept "Accural Basis" states that transactions are to be recorded to the accounting period in which they relate. Since the customer has pre ordered at the end of the financial year, the fee of $90 received in advanced must be reported as an ~~prepayment~~ "accured income" in both the Statement of Financial Position and Income statement, as Fancy Pants is still owing the service that both parties agreed on prior to the pre-ordered costume.

~~The reason for this is because it keeps the balance~~ The reason that this is recorded in both the Statement of Financial Position and the Income Statement is because it shows that Jessica still owes this service therefore it becomes a current liability, but also in the income statement it is also put under "Hire Fees" as it is also an income.

N2

The student has given a partial definition of accrual basis

This page has been deliberately left blank.
The examination continues on the following page.

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QUESTION TWO

The main source of income for *Fancy Pants* is hire fees from costume hire. During her first year of operating, Jessica introduces the sale of accessories such as make-up to match the Dracula costume and masks for Halloween. Below is an extract from the Income Statement for *Fancy Pants* for 2013 and 2014.

Fancy Pants **Income Statement (extract) for the period ended 31 March**		
	$NZ	**$NZ**
	2013	**2014**
Revenue		
Hire fees	75000	80000
Other income		
Accessory sales	0	5700
Total income	**75000**	**85700**

In 2014, hire fees for *Fancy Pants* are $70000 cash and $10000 credit transactions.

(a) Justify why hire fees on **credit** are an income for *Fancy Pants*. Include in your answer:
- the **definition** of an **income** to explain why the hire fees on **credit** are an income
- an explanation of the **recognition criteria** of an income as related to hire fees on **credit**.

Hire Fees on credit are an income for Fancy Pants because Fancy Pants are providing the customers with a service in which creates future economic benefit for Fancy Pants. The $10000 credit transactions are also an income for Fancy Pants as the amount paid goes straight to Fancy Pants' bank account. This meets the definition of an Income, something that provides a flow of future economic benefit that increases assets, and equity also creates a profit for the business and decreases liabilities.

The student has not described income or the recognition criteria

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Following one year of trading, Jessica is not sure if she is reporting the Revenue and Other Income for *Fancy Pants* correctly.

(b) With reference to the Income Statement extract on the previous page, justify in terms of **relevance** and **materiality** why accessory sales are reported separately from the hire fees income.
Include in your answer:
- an explanation of how the qualitative characteristic of **relevance** has been applied in the reporting of **accessory sales**
- an explanation of how the qualitative characteristic of **materiality** has been applied in reporting **accessory sales** separately from **hire fees income**.

The qualitive characteristic of Relevance has been applied in the reporting of Accessory sales as it has been reported seperately from Hire-Fees, this gives more accurate information on Fancy Pants' income by seperating into two accounts, by keeping accessory sales relevant.
The qualitive characteristic of materiality has been applied in the reporting accessory sales seperately from the hire fees income, by, seperating the two the information in any financial statement becomes much more accurate and reliable. Also this is only a small income of $5700, Jessica has done the right thing by seperating the smaller income job from the larger, to keep materaility.

The student has attempted to describe how accessory sales are material

N1

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QUESTION THREE

Fancy Pants currently uses different methods for the depreciation of its non-current assets. However, Jessica is not sure that she is using the correct methods. The office computer is depreciated using the **diminishing value** depreciation method, and the costumes are depreciated using the **units of use** depreciation method.

(a) Justify to Jessica the methods of depreciation chosen for reporting both the office computer and the costumes in the financial statements of *Fancy Pants*.
Include in your answer:

- a description of the **diminishing value** method of depreciation
- a description of the **units of use** method of depreciation
- explanations for whether the correct depreciation method is being used for the office computer and the costumes.

- The diminishing value method of depreciation means that within the first few years of purchase the value will start to decrease/diminish. It also continues to drop/decrease lowering its value //
- The units of use method of depreciation means that each theme is a set amount of how many times the item will be used, depending on how many times it is used this will influence the ~~dep~~ decrease the value of the item which in this case is the costumes. //

The student has attempted to describe the depreciation methods

The student has named a source document for the qualitative characteristic verifiability and described capital expenditure.

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(b) Jessica has recently expanded the business into providing formal wear for hire at weddings and school balls.
A consequence of expanding the business is that Jessica had to purchase on credit more **cleaning equipment**, at a cost of $2800, to clean and launder the various costumes, dresses, and suits available for hire.

Justify why *Fancy Pants* will report the **cleaning equipment** as a non-current asset in the Statement of Financial Position.
Include in your answer:

- the use of the **definition** of an **asset** to explain why the cleaning equipment is an asset
- an explanation of a cost for the cleaning equipment that meets the qualitative characteristic of **verifiability**
- an explanation of how the purchase of the cleaning equipment meets the definition of **capital expenditure**.

- The cleaning equipment meets the definition of an asset because ~~it will be a~~ it is a result of an past transaction and will be used to clean costumes, ball dresses and suits to attract customers which will generate future economic benefit for Fancy Pants. //
- The cost of the cleaning equipment can be verified with the receipt Jessica has to prove the cost of the equipment which will need to be stated in the Statement of Financial Position. //
- The purchase of the cleaning equipment meets the definition of capital expenditure as it was a one off payment for the purchase which will also result in an future economic benefit for Fancy Pants and Jessica. This expenditure is not of recurring nature //

N2