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2

91174



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Level 2 Accounting, 2015

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

2.00 p.m. Friday 20 November 2015
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 2–12 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

6

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QUESTION ONE

Healthy Greens is a market gardening business owned by Maia that supplies salad greens and other vegetables to local restaurants and hotels on the west coast of the South Island.

Maia has been in business for three successful years. In October 2014, Maia was given a bank loan to finance the purchase of a new delivery truck after she provided the bank manager with the following information.

Healthy Greens Income Statement (summary) for the periods ended March			
	2012	2013	2014
	\$	\$	\$
Sales	24 000	32 000	41 000
Total expenses	12 200	13 300	15 300
Profit for the year	11 800	18 700	25 700

- (a) Justify how important the information in Healthy Greens Income Statement was to Maia's bank manager when he considered her loan application. In your answer, explain:
- the **purpose** of the Income Statement
 - how the **reporting period** concept has been applied
 - how the qualitative characteristic of **comparability** enabled the bank manager to make the loan decision, with examples.

The purpose of an ~~income~~ income statement is to measure the profit/loss for the period. It can be seen that the profit for Healthy Greens has increased from 2012 (\$11 800) to 2013 (\$18 700) and has increased again in 2014 to \$25 700, which has a positive effect on Healthy Greens. The reporting period states that the transactions or other events that have occurred will be divided into nominated time periods. In Healthy Green's income statement, the profit for the year is divided into the time periods for the periods ended March in //

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2012, 2013 and 2014. By using the reporting period concept, this benefits Healthy Greens when using the qualitative characteristic of comparability. This is because information is more useful when it is compared to similar information of different entities or compared to similar information of the same entity for a different reporting period or date. In this case, the Bank manager can compare Healthy Green's income statement, regarding the same information of the profit for each year. By doing this, the bank manager can recognise that the profit has substantially increased from 2012-2013-2014. This has a positive on Maia as because her business's profit has increased, this will ^{made} possibly make it more likely for the bank manager to grant her a loan to finance the purchase of a new delivery truck.

The student has described comparability in the context of the income statements for Healthy Greens, that is, the profit has increased from 2012 - 2014.

Following is an extract of the Statement of Financial Position for *Healthy Greens* showing the loan that was approved by the bank manager.

<i>Healthy Greens</i> Statement of Financial Position (extract) as at 31 March 2015		
	Note	\$
Non-current liabilities		
Loan	4	20 000

Note to the Financial Statement

4. Loan

The loan has an interest rate of 10% and a maturity date of 31 March 2020

- (b) Justify why *Healthy Greens* has reported the loan in the Statement of Financial Position (extract) as a \$20 000 **non-current liability**.

In your answer, explain:

- using the definition of liability, why the loan is a liability
- how the qualitative characteristic of **faithful representation** is being met by reporting the loan as non-current.

A liability is the future outflow of resources embodying the economic benefit that an entity is presently obliged to make to other entities as a result of a past transaction. *Healthy Greens* loan is a liability as it is money that the business will have to pay back to the bank over time. The note states that when paying the loan back, *Healthy Green's* loan has an interest rate of % and a maturity date of 31 March 2020, meaning that the loan should be paid off by that date. The loan is considered to be a non-current liability because it will be paid off in the long-term, which embodies *Healthy Greens* economic benefit as ^{some} money earned as a profit for *Healthy Greens* will have to

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be used to pay off the \$20 000 loan. Faithful representation is met by reporting the loan as non-current as the qualitative characteristic means that information should be complete, neutral and free from error. This is met as *Healthy Greens* has correctly classified the loan to be a non-current liability, meaning that there is no misunderstanding that the loan will be paid off in the long term.

The student has given a partial definition of faithful representation

The student has given a partial definition of liability and a partial explanation of a non-current liability

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QUESTION TWO

During the year ended 31 March 2015, Maia expanded her business to supply more restaurants and hotels in the South Island.

This has resulted in *Healthy Greens* accounts receivable asset increasing.

- (a) Justify why **accounts receivable** is an **asset** for *Healthy Greens*.
In your answer, explain:

- using the definition of an asset, why accounts receivable is an asset
- how the asset accounts receivable can be measured reliably.

Assets are the future economic benefits that are presently controlled by the entity as a result of a past transaction. Accounts receivable is an asset because *Healthy Greens* is receiving payments from customers for her products of salad greens and other vegetables, which increases the economic benefit of *Healthy Greens* as more money is coming into the Business's bank account. Accounts receivable is also controlled by *Healthy Greens* as Maia can choose which customers she wants to supply. Accounts receivable is a result of a past transaction as there will have been a payment made to *Healthy Greens* in order for customers to receive their produce. The asset of accounts receivable can be measured with reliability by following the recognition criteria that it is probable that the item will provide a form of inflow (assets/incomes) or outflow (liabilities, expenses). The item will also have to have a cost of value to be measured reliably. It is seen that accounts receivable is measured reliably as it's a form of inflow as it is an asset and it also has a cost with money coming into *Healthy Greens* account.

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Maia's accountant advised her that with accounts receivable increasing, the allowance for doubtful debts needed to be adjusted to 2% of accounts receivable for the year ended 31 March 2015.

- (b) Justify the reporting of the adjustment of the allowance for **doubtful debts** to 2% of accounts receivable in the financial statements of *Healthy Greens*.
In your answer, explain:

- using the definition of **expense**, why doubtful debts is reported in the Income Statement
- how the qualitative characteristic of **relevance** has been applied in the reporting of accounts receivable in the Statement of Financial Position.

An expense is a decrease in the economic benefit in the form of outflows which occur when assets decrease or liabilities increase which do not relate to the owner and a decrease in equity. Doubtful debts are recorded in *Healthy Greens* income statement as an expense because there is the possibility that *Healthy Greens* will not receive all of the money from accounts receivable. The qualitative characteristic of relevance suggests that ~~information is more~~ by providing relevant information to users this has the ability to influence their decision. In terms of accounts receivable, this is seen as a predictive value which acknowledges information in the present and in the future. This allows Maia to evaluate the fact that accounts receivable is increasing, therefore influencing her decision to adjust doubtful debts of 2% of accounts receivable for the year ended 31 March 2015.

The student has described
the definition of relevance

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N2

11

QUESTION THREE

The total amount spent on diesel for the *Healthy Greens* delivery truck during the month of March 2015 was \$250. Maia estimates that she used \$50 of this amount for a personal trip to Greymouth.

- (a) Justify how Maia will report the \$250 spent on diesel in the **financial statements** of *Healthy Greens*.
In your answer, explain:
- using the definition of **revenue expenditure**, how the \$200 spent on diesel will be reported
 - using the **entity concept**, how the \$50 spent on diesel will be reported.

Revenue expenditure is a continued ~~expense~~ ^{expense} that usually maintains or upkeeps assets that a business already owns. ~~It is an expense~~ in order to maintain the economic benefit of such assets. In this case, the ~~the~~ ^{diesel} expense is a revenue expenditure as it maintains the usability of an asset (you can't drive a truck without fuel). On a sustained, long term basis - there are no intentions to sell the truck, therefore stop paying for diesel, within the next business year.

The entity concept means that a business & its owners are two separate financial entities. ^{the revenue of Healthy Greens does not} ~~the revenue of Healthy Greens does not~~ necessitate payment to Maia.

Therefore, Maia's personal usage of the van draws up expenses that will be reported as drawings, as the definition of an ~~asset~~ ^{expense} defines it is not a distribution to the owner. Therefore, the \$50 of Maia's personal usage of the van ~~is~~ ^{is not} an expense but a drawing.

It will be recorded as such in the *Healthy Greens* financial statements.

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On balance day, 31 March 2015, *Healthy Greens* GST payable was \$1000, and Maia had the following invoice for salad greens sales on hand.

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Healthy Greens 800 Karamea Highway, Little Whanganui			
Invoice No:	13368	Delivery date:	28 March 2015
Customer:	Three Brothers Hotel	Payment due:	7 April 2015
Customer ID:	364		
Address:	46 Main Road, Karamea		
Phone:	03 573 6829		
Quantity	Description	Unit price	Line total
10	Red oak leaf lettuce	1.50	15.00
10	Buttercrunch lettuce	1.50	15.00
		Subtotal	30.00
		GST	4.50
		Total	\$34.50

Thank you for your business!

- (b) Using the **accrual basis**, justify **how** and **why** the invoice for salad greens sales was reported in both the Income Statement and Statement of Financial Position for *Healthy Greens*.

Accrual basis defines that ~~the~~ a transaction's effects will be reported in the financial period the transaction ~~it takes~~ ^{takes} place in, regardless of when the actual changing hands of money ~~take~~ ^{takes} place. In this way, although payments from 3 Brothers Hotel to *Healthy Greens* will take place on April 7, the transaction's reported period will be in March, when it was recorded.

The payment will ~~therefore~~ be recorded on financial statements as ~~accrual~~ ^{income}, indicating a ~~balance day adjustment~~. Therefore, despite lack of payment, the invoice will be recorded in the March income statement & statement of financial position.

The student has given a partial definition of accrual basis.

N2