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2

91174



NEW ZEALAND QUALIFICATIONS AUTHORITY  
MANA TOHU MĀTAURANGA O AOTEAROA

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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.**

Low  
Achievement

TOTAL

8

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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.

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

- (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 the income statement is to view the sales and expenses and compare the two with each other to see the profit made for the year. //
- The reporting period concept states that financial statements will be made at least annually. //
- The qualitative characteristic of comparability means that information is more useful if it can be compared with previous statement from the same or different businesses. //

- The reporting period concept has been applied as by seen on the income statement above, the years of 2012, 2013,

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and 2014 all have an income statement made for their respective years. //

- The qualitative characteristic of comparability has helped the bank manager to make a loan decision as he can compare <sup>the bank manager</sup> *Healthy Greens* income statements for the past 3 years and can use that to assist making a decision. The bank manager can see that the business, *Healthy Greens*, has been consistently been performing well and making a healthy profit for the year for all of the past 3 years. The bank manager can also see that the businesses sales are slowly increasing. //
- An example is that if all 3 years weren't shown, the business could've done poorly the past two years and made minimal to no profit at all, meaning that the business could be very inconsistent and may not have such a good year next year meaning that they won't be able to pay back the bank loan. //

The student has described comparability in the context of the income statements for *Healthy Greens*.

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

<b>Healthy Greens</b> <b>Statement of Financial Position (extract) as at 31 March 2015</b>		
	<b>Note</b>	<b>\$</b>
<b>Non-current liabilities</b>		
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.

• ~~The~~ The loan is a liability because there was a past transaction when the \$20,000 switched hands from the bank to Healthy Greens. ~~Healthy~~ There is a present obligation as Healthy Greens are obliged to pay the \$20,000 when it falls due in 2020, and there is also a future economic outflow as Healthy Greens will have to pay back the full amount plus interest so that is an outflow of cash for Healthy Greens //

• The qualitative characteristic of faithful representation ~~means~~ is being met by reporting the loan as a non-current asset as the loan does not fall due within the ~~next~~ next year, meaning it is a non-current liability, not a current liability. //

"Healthy Greens will report the loan as a non-current liability because firstly, it meets the definition of a liability and secondly, it has to be faithfully represented and it is due in 5 years time, classing it as a non-current liability. //

The student has explained why the loan meets the <sup>definition</sup> past, present and future requirements of a liability

## QUESTION TWO

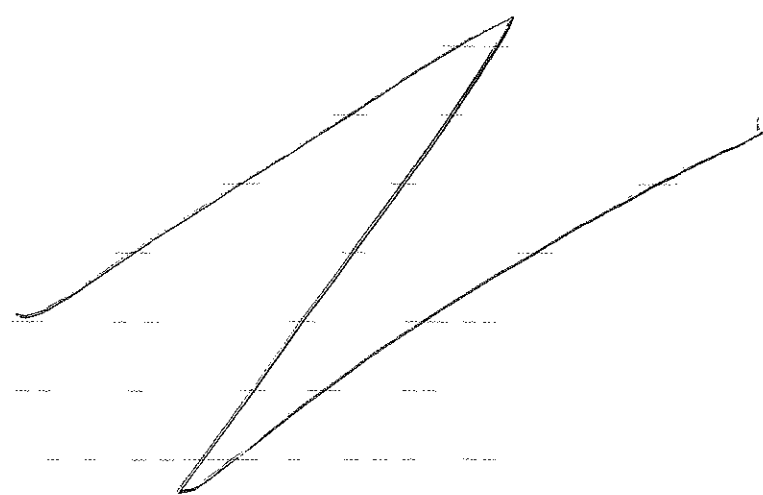
During the year ended 31 March 2015, Maia expanded her business to supply more restaurants and hotels in the South Island.

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.

• Accounts receivable is an asset as there was a past transaction when the good(s) was purchased, there is present control as the money owing is now *Healthy Greens*, and there is future economic benefit as when the money is paid to *Healthy Greens*, there will be economic inflow.

• Accounts receivable can be measured reliably through the use of an invoice. An invoice shows that the transaction has in fact taken place and is proof that the money is now owed to *Healthy Greens*.  
// The student has explained how the invoice is a reliable measure.



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.

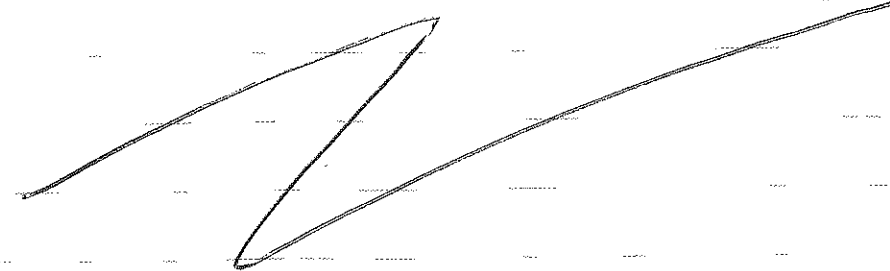
- (b) Justify the reporting of the adjustment of the allowance for **doubtful debts** to 2% of accounts receivable in the financial statements of *Healthy Greens*.  
In your answer, explain:
- using the definition of **expense**, why doubtful debts is reported in the Income Statement
  - how the qualitative characteristic of **relevance** has been applied in the reporting of accounts receivable in the Statement of Financial Position.

• An expense decreases an asset or increases a liability, decreases owner's equity and is not a distribution from the owner. // ~~increases allowance for doubtful debts~~  
• Doubtful Debts ~~decreases accounts receivable~~ which is an ~~asset~~ <sup>liability</sup>, decreases owner's equity, ~~gross profit~~ decreases, and doubtful debts is not distributed from the owner.

Doubtful Debts meets the characteristics of an expense, meaning it gets reported in the income statement where both income and expenses are reported. //

• The qualitative characteristic of relevance has been applied in the reporting of accounts receivable in the Statement of Financial Position as we assume that the money owed by customers in the form of credit ~~is~~ will be paid to the business. It is relevant because the accounts receivable amount can influence a decision to be made in the business. //

The student has described the definition of relevance.



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## 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 classified as money that is used in the running of an asset. The \$200 spent on diesel will be reported as an expense in the income statement.

The entity concept states that the affairs of the owner and business are kept separate. The \$50 spent on diesel for personal use will be reported as ~~an expense~~ since it is not be reported in the statements as the \$50 ~~relates to~~ does not relate to the business, it is personal use. The expense of \$50 is not relevant to the business.

The student has given a partial definition of revenue expenditure.

On balance day, 31 March 2015, *Healthy Greens* GST payable was \$1 000, and Maia had the following invoice for salad greens sales on hand.

<b>Healthy Greens</b> 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
Thank you for your business!		Subtotal	30.00
		GST	4.50
		Total	\$34.50

- (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*.

The accrual basis states that transactions are reported in ~~what~~ the period to which they relate.

The student has given a partial definition of accrual basis concept.

The salad greens sales will firstly be reported in the income statement as sales. This is because the goods have been delivered before the 31st of March. So the goods are not the business any more as they have been sold. The salad greens meet the classification of income as they increase an asset, accounts receivable, hence increasing owner's equity ~~in the business~~ since profit increases, and is not a contribution from the owner. They relate to the current period.

The salad greens are reported in the Statement of Financial position as accounts receivable as the goods have exchanged hands and the money is now owing to Healthy Greens. It meets the criteria of an asset as there was a past transaction, recognised by the invoice, current control as Healthy Greens are now in charge of the money which is owed and can choose what to spend it on, future economic benefit as when the money is received by Healthy Greens, they are economically benefited.

Because of the accrual basis, the salad greens do relate to the current period, resulting in them being reported in both statements.

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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.

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

- (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 the income statement is to calculate total revenue, total expenses and Net Profit for the year ended. //

The reporting period concept states that the lifetime of a business should be ~~div~~ divided up into equal periods. The period reporting concept has been applied because the table shows the income statements for the last three accounting periods of equal length from 1st April to 31st March. //

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The qualitative characteristic of comparability enabled the bank manager to make the loan decision because the income statements for the last 3 years are able to be compared between as they are formatted the same and are for the same length of time and all of the statements only include Healthy Greens income and expenses. Therefore the bank manager can see the growth of Healthy Greens and decide whether or not they will be able to repay the loan. //

The student has explained how the reporting period has been applied to healthy greens and

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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	\$
<b>Non-current liabilities</b>		
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.

There was a transaction made in the past and *Healthy Greens* is obligated to repay it. They signed a contract and the loan of \$20 000 will be reported as a liability in *Healthy Greens* balance sheet because there will be an outflow of resources, cash when the loan is paid for which will result in a decrease in Equity. ~~and the loan is not drawings by the owner of Healthy Greens. The loan is a non-current liability because it does not need to be repayed till 31 March 2020.~~

The qualitative characteristic of faithful representation is being met by reporting the loan as non-current because *Healthy Greens* will have an invoice that is free from error and bias and show a fair and neutral view of the transaction and the repayment date. //

The student has described in the context of the loan the past transaction and the present obligation.

## 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.

Accounts receivable is an asset for Healthy Greens because there was a transaction in the past when Healthy Greens sold the goods on credit. Healthy Greens have present control over their debtor and can add penalties if the accounts are not paid for on time. Healthy Greens will receive future economic benefits in the form of cash ~~th~~ when the debtors pay their accounts. //

The reliable measure for the Accounts Receivable will be the invoices given out to the credit customers which faithfully represent the transaction as they are neutral and free from error and bias. //

The student has correctly described the past and future parts of the asset's definition in the context of accounts receivable and

The student has explained how the invoice is the reliable measure.

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.

Doubtful debts is an ~~income~~ expense for Healthy Greens as it will result in a decrease in the asset accounts receivable and therefore decrease equity. Doubtful debts are not drawings by Maia the owner of Healthy Greens. //

The qualitative characteristic of relevance has been applied in reporting the Accounts Receivable in the Balance Sheet because the Accounts Receivable is relevant to Healthy Green statement of financial position and will have a noticeable effect on the Net Assets and Equity figures. //

The student has described the decrease in accounts receivable and described how the decrease in equity is not drawings by Maia.

## 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.

Diesel is revenue expenditure for Healthy Greens because it is a re-occurring expenses and is used up within the accounting period. The \$200 spent on diesel will be reported as an expense in the income statement.

The entity concept states that the financial affairs of Healthy Greens must be kept separate and distinct from those of Maia. The \$50 spent on diesel will be reported as drawing because it is not a business expense.

The student has explained how the diesel fuel is revenue expenditure and how the diesel fuel will be reported in the income statement and

The student has described the entity concept in context of the diesel fuel

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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.

<b>Healthy Greens</b> 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

- (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*.

The accrual basis states that all transactions should be recognised or reported in the period with they relate to. The invoice for salad greens sales will ~~increase~~ be reported as accounts receivable of \$34.50 in the balance sheet, and \$ increase sales by \$30.00 in the income statement and increase the GST payable by \$4.50 to make the GST payable total \$1004.50 in the balance sheet as a current liability.

The student has described accrual basis concept in context of the invoice for healthy greens

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