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Level 2 Accounting, 2016

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

2.00 p.m. Tuesday 22 November 2016
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 2–14 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.

Excellence

TOTAL

2%

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QUESTION ONE

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Wiremu owns *Beachsplash*, a kayak hire shop at Whatuwhiwi Beach, Northland. Wiremu has noticed the rise in popularity of paddle boarding and wishes to add paddle board hire to his kayak hire business.

On 1 April 2015, Wiremu provided *Torpedo7* (a supplier of paddle boards) with a summary of *Beachsplash*'s Cash Flow Statements for the previous two years. *Torpedo7* will use this information to decide whether to approve the purchase of paddle boards on credit by *Beachsplash*.

Beachsplash		
Cash Flow Statement (summary) for the years ended 31 March		
	2014	2015
	\$	\$
Total receipts	145 000	170 000
Total payments	137 000	145 000
Net increase (decrease) in cash	8 000	25 000

- (a) Justify how the information contained in the Cash Flow Statement (summary) above would support a decision by *Torpedo7* to approve *Beachsplash*'s purchase of the paddle boards on credit. In your answer explain:

- the **purpose** of a Cash Flow Statement
- how the Cash Flow Statement summary for *Beachsplash* illustrates **monetary measurement**
- how the qualitative characteristic of **comparability** would support *Torpedo7* in making a decision to approve *Beachsplash*'s purchase of the paddle boards on credit.

The purpose of a cash flow statement for Beachsplash is to show the ability of Beachsplash to generate inflows of cash into the business as well as helps Wiremu ~~see~~ recognize where the cash of Beachsplash is flowing out towards. In addition, the cash flow statement ~~is~~ will help Wiremu see if there is enough cash being generated in order to enable the possibility of making expansions on Beachsplash's operation or pay back their debts to suppliers potential suppliers such as Torpedo7.

The monetary measurement concept is applied in the reporting of Beachsplash's cash flow statements for years ²⁰¹⁴ ~~ended~~ and 2015 ^{ended} 31 March because the values ~~measured~~ of cash that has been received or paid ~~is~~ \$ by Beachsplash are measured ^{N2} and recorded in dollar terms (\$), ~~as well as in accordance to the N2 currency rate~~

The reporting of the cash flows statement of Beachsplash ~~is~~ fulfills the ^{qualitative characteristic} concept of comparability because for the statements of ~~2014~~ 2014 and 2015, each ^{cash flow} statement ends at 31 March of the year which makes ^{them} consistent and timely that the net increase or decrease of cash for a particular period can be compared with ^{amounts of} consecutive years.

The net increase ⁱⁿ Beachsplash's cash flow statements for the years 2014 and 2015 are \$2000 and \$25000 which

Torpedo7 can compare and recognize the trend in the net increase in cash. This will ensure Torpedo7 that Beachsplash is highly capable ~~of~~ ~~to~~ ~~not~~ ~~flow~~ sustaining a sufficient cash flow and is likely to ~~payback~~ repay the debts of the paddle boards that will be purchased on credit.

In April 2015, *Beachsplash* purchased the paddle boards **on credit** from *Torpedo7* for a total cost of \$15 500. The paddle boards are to be reported as a non-current asset.

- (b) Justify why *Beachsplash* will report the paddle boards as a non-current asset. In your answer, explain:
- using the **definition** of an **asset**, why the paddle boards are reported as an asset
 - the **recognition** criteria of an asset, as it relates to the paddle boards
 - why the paddle boards are reported as **non-current**.

An asset is something that has ~~been~~ rose from a past event or transaction and is within the present control of the business. It will ~~also~~ provide ~~future~~ economic benefits to the business in the future. In this case, the paddle boards of *Beachsplash* are assets of the business because it rose from the past event of *Beachsplash* purchasing the paddle boards on credit for \$15 500. ~~the contract that was settled between Torpedo7 and Beachsplash~~ The paddle boards are in the present control of *Beachsplash* ~~because the owner can decide who wants to use~~ because *Beachsplash* can decide who ~~wants to use~~ can use it such as the customers of *Beachsplash*. The paddle boards will provide future economic benefits to *Beachsplash* ~~when~~ because the customers will be able to ~~use~~ hire them for their own entertainment which will generate an inflow of cash in the form of revenue and will increase the asset bank of *Beachsplash*.

An item or source

~~An asset~~ is ~~recognized~~ recognizably an asset of the business if it is probable that future economic benefits will flow into the business, and it has a cost or value that can be measured reliably. The paddle boards of Beachsplash can be recognized as assets because it is probable that economic benefits will flow into ~~the business~~ ^{Beachsplash} in the form of cash from revenue when ~~customers~~ ^{the regular customers} of Beachsplash use them. The paddleboards ~~can~~ ^{has a cost that} be measured reliably which ~~is~~ ^{are the} ~~the~~ ^{incomes} ~~for~~ ^{that} Beachsplash will receive ~~for~~ the paddleboards worth \$15500.

The paddle boards are reported as non-current in the Statement of Financial Position of Beachsplash because they are ~~not~~ expected to be realised beyond the next reporting period. This means that the paddle boards will be ~~and~~ kept in Beachsplash for an extended period of time for the use of customers when they hire it. ~~It will also be~~ The paddleboards have a long useful lifetime ~~that they will not~~ as well.

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QUESTION TWO

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In order to let the Whatuwhiwhi Beach community and visitors know that *Beachsplash* now hires out paddle boards as well as kayaks, Wiremu contracted a builder to install a permanent billboard on *Beachsplash*'s roof. The billboard was installed in April 2015 at a cost of \$8 000 and will be reported as a non-current asset.

Wiremu will use different depreciation methods for the billboard and paddle boards. He will depreciate the billboard using the straight-line depreciation method, and the paddle boards using the units-of-use depreciation method.

- (a) Justify the depreciation methods chosen by Wiremu for the billboard and the paddle boards. In your answer:

- describe the **straight-line** depreciation method
- describe the **units-of-use** depreciation method
- explain why straight-line depreciation is appropriate for the billboard
- explain why units-of-use depreciation is appropriate for the paddle boards.

~~The straight-line depreciation method~~

Depreciation is the expense that is incurred from using up the economic benefits of the non-current assets of property, plant and equipment over its useful life. The straight-line depreciation method is ~~then~~ used when the usage of the economic benefits of an asset ~~is consistent~~ over its useful life is consistent every reporting period. The units-of-use depreciation method is used when the usage of the economic benefits of an asset is calculated according to the amount of times that it is used rather than a period of time that it is useful for.

The billboard of ~~Beach~~ Beachplash is ~~consistently~~ appropriately depreciated using the straight-line depreciation method because it is ~~constantly~~ constantly in use as it remains standing on ~~top~~ the roof of Beachplash. Therefore it will consistently wear out by its repetitive exposure to the sunlight ~~and~~ and bad weather conditions at Whakawhiri beach, Northland.

The paddleboards of Beachplash is appropriately depreciated using the units-of-use depreciation method because ~~of~~ the paddleboards are ~~likely~~ more likely to wear out and lose its economic benefits everytime a customer is using it ~~where in such a way that it is exposed to the influence~~ water. ~~If a paddleboard of Beachplash are depreciated~~ Using the straight-line depreciation method to depreciate the paddleboards of Beachplash is not appropriate because a paddleboard being stored away ~~at~~ in the store without much use of it will be exposed to ~~no harm~~ no harm and will not wear out consistently therefore giving an unfaithful representation of the depreciable amount for the paddleboards of Beachplash ~~any~~ per reporting period.

In addition to the billboard (which cost \$8 000), Wiremu also spent \$250 purchasing a footpath sign that is placed outside Beachsplash's premises each day. The billboard and footpath sign by definition are both **assets**, but in the Financial Statements Wiremu intends to report the billboard as a **non-current asset** and the footpath sign as an **advertising expense**.

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- (b) Justify Wiremu's intention to report the footpath sign as an advertising expense in Beachsplash's Financial Statements. In your answer:
- explain how **historical cost** will be applied to the reporting of the footpath sign
 - describe the qualitative characteristic of **materiality**
 - explain why **materiality** will enable Wiremu to report the **footpath sign** as an advertising expense.

The footpath sign ^{of Beachsplash} will be reported at the amount that it was paid for at the very first instant. This aligns with the concept of historical cost. As the footpath sign of Beachsplash will be reported at \$250, it will enable Wiremu to compare that value with the ~~value~~ historical cost of the billboard which is \$8000. The qualitative characteristic of materiality is about the inclusion and non-inclusion of financial information and whether or not it will affect the economic decisions of the ~~business~~ owner. ~~Beachsplash~~ The inclusion and non-inclusion of financial information are ~~also related to~~ determined by the size and nature of the ^{information} ~~particular source or item concerned~~. Beachsplash will report the footpath sign as an advertising expense under the decision of Wiremu because he can ~~see~~ recognize that the purchase of the \$250 footpath sign is much smaller compared to the \$8000 billboard.

that is a non-current asset of Beechplast. This makes the footpath sign immaterial and will not ~~be~~ be relevant enough if it was included ~~is it~~ as a non-current asset beside the billboard.

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QUESTION THREE

Beachsplash also provides paddle board lessons. The lessons and associated hire of paddle boards are reported as Paddle Board Hire and Lesson income. In the last week of March 2016, *Beachsplash* invoiced a school \$500 for paddle board hire and lessons for that week.

- (a) Justify why *Beachsplash* will report the \$500 for paddle board hire and lessons as income in the Income Statement for the year ended 31 March 2016. In your answer, explain:
- using the **definition of income**, why the \$500 for paddle board hire and lessons is income
 - how the qualitative characteristic of **faithful representation** is being met by reporting the \$500 paddle board hire and lessons as income.

The \$500 for the paddle board hire and lessons is an income of *Beachsplash* because it will provide an inflow of economic benefits when the school eventually pays the \$500 in cash which will increase the asset base of *Beachsplash*. This will increase the net profit of *Beachsplash* at the end of the reporting period which is 31 March 2016. This will increase the equity of *Beachsplash* yet is not a contribution made by Wisnom.

The \$500 for the paddle board hire and lessons by *Beachsplash* meets the qualitative characteristics of faithful representation as it is reliable, relevant, comparable and understandable. ~~The \$500~~ It is free from material error and bias as ~~it is not~~ there is a copy of the invoice that was sent to the school concerning the credit transaction. It is relevant to *Beachsplash* as it will enable Wisnom to make future predictions about the ~~the~~ economic benefits that will flow into *Beachsplash* due to the increase in ~~revenue~~ revenue. It is comparable with other income of *Beachsplash* from consistent reporting periods that have also ~~risen from~~ arisen from credit transactions. It is understandable because it aligns with the ^{basis} ~~accounting~~ ^{basis} of *Beachsplash* which users must be aware of.

Beachsplash's Cash Flow Statement for the year ended 31 March 2016 reports paddle board hire and lesson income as \$28 000. This includes a deposit of \$1 000 from the local school holiday programme to secure paddle board hire and lessons for the April 2016 school holidays.

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- (b) Using the **accrual basis**, explain **how** and **why** the deposit of \$1 000 from the local school holiday programme was reported in both the **Income Statement** and the **Statement of Financial Position** for Beachsplash for the financial year ended 31 March 2016.

The accrual basis assumption ^{means that} ~~is about~~ all transactions of a business are recognized when they occur and are reported in the period to which they relate. The deposit of \$1 000 from the local school holiday programme is related to the following period ending at 31 March 2017, because the service of the paddle board hire and lessons are not due until ~~after the~~ April 2016 from Beachsplash.

Therefore in Income Statement of Beachsplash for the year ended 31 March 2016, the existing ^{income} ~~expense~~ account of Paddle Board Hire and Lesson income will decrease by \$1 000 because the transaction made by the local school

holiday programme does not relate to the current period and Beachsplash have not earned that income. In the Statement of Financial Position of Beachsplash for the year ended 31 March 2016 a new current liability account called Income Received in Advance will be created which will be valued at \$1 000 because the transaction from the school holiday programme is ~~has not been earned by~~ Beachsplash are now obligated to prepare the paddle boards and for hire and lessons for the following period ~~at~~ on April 2016 and ready for the holiday programme of the local school.

Extra space if required.
Write the question number(s) if applicable.

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QUESTION
NUMBER

Annotated Exemplar

Excellence exemplar 2016

Subject:	Accounting	Standard:	91174	Total score:	21
Q	Grade score	Annotation			
1	7	<p>1 (a) The candidate has justified how the monetary measurement has been illustrated in the cash flow statement and explained how the qualitative characteristic of comparability has been applied to <i>Beachsplash</i> by explaining how the net increase in cash from \$8 000 to \$25 000 is a favourable trend that will allow <i>Torpedo 7</i> to see that <i>Beachsplash</i> will likely be able to repay its debt.</p> <p>1 (b) The candidate has correctly described why the paddle boards are an asset, using the characteristics of past transaction and future economic benefit. The candidate has explained how the recognition criteria is being met for both reliability and probability and has explained why the paddle boards are a non-current asset.</p>			
2	7	<p>2 (a) The candidate has accurately explained the straight-line and units-of-use methods of depreciation and justified why each method is appropriate for the billboard and the paddle boards.</p> <p>2 (b) The candidate has described the meaning of materiality and how the footpath sign is an immaterial amount in relation to the billboard.</p>			
3	7	<p>3 (a) The candidate has correctly used the definition of income to describe why the \$500 paddle board hire and lessons is income by correctly linking the hire and lesson income to accounts receivable increasing (or bank increasing when cash is received from the school in the future) net profit, increasing equity, and not a contribution by Wiremu. The candidate has described faithful representation by making reference to a source document and terminology but has not explained how the \$500 figure is faithfully represented.</p> <p>3 (b) The candidate has used the accrual basis concept to justify how and why the deposit of \$1 000 is applied to the Income Statement by explaining that the paddle board hire income will decrease by \$1 000, the reason being that <i>Beachsplash</i> has not yet earned the income. The candidate has used the accrual basis concept to justify how and why the deposit of \$1 000 is applied to the Statement of Financial position by explaining that the current liability income received in advance will increase because <i>Beachsplash</i> has an obligation to provide the paddle board hire and lessons for the following accounting period.</p>			