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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.**

**Excellence**

**TOTAL**

**23**

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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
<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 show the revenue, expenses and profit/loss for a period (usually a year) for Healthy Greens.

The reporting period concept states that Healthy Greens' continuing life is divided into nominated time periods of equal length, in Healthy Greens' case one year, to measure financial performance on a timely/regular basis. The period reporting concept has been applied because Healthy Greens has divided their continuing life into one year periods for their income statements, ~~as the statement is~~ for the period ended March every year, and this

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is consistent with their income statements from 2012-2014. Comparability allows users, such as the bank manager, to identify trends (similarities and differences) in Healthy Greens' income statement and compare it to previous periods so they can make informed decisions such as the loan decision, based on their financial performance. Having the last 3 years income statements has provided comparability to the bank manager as he has been able to identify profit trends. Sales has increased each year at a much higher rate than the increase in expenses which shows that Healthy Greens will be able to pay back a loan along with interest as they are generating a <sup>successful</sup> profit. Also, it shows that for the past 3 years, profit has increased at a consistent rate (\$11800 to \$18700 to \$25700) which shows that the profit trend is likely to continue in the future, which enables the bank manager to see that Healthy Greens will most likely make loan repayments on time along with interest in the future.

⊗ The expenses have been kept low as well.

The student has justified how the reporting period concept has been applied to Healthy Greens and how the qualitative characteristic of comparability has been applied to Healthy Greens and how the bank manager can use the information to make a decision.

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

Healthy Greens 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.

The loan is a liability because it arises from a past transaction when *Healthy Greens* took out a loan of \$20 000 from the bank to finance the purchase of a new delivery truck. *Healthy Greens* is presently obliged to pay back the loan as there will be a contract in place between the bank and *Healthy Greens* showing the amount owed \$20 000. The loan will also result in an outflow of future economic benefits in the form of cash (bank) from *Healthy Greens*, when the loan is repaid in the future.

Faithful representation means that information is accurately reported so that it is complete, free from error and neutral. Reporting the loan as a non-current liability shows that *Healthy Green* expects to pay off the loan over a number

of accounting periods i.e. beyond the next accounting period. This means it will be reported at its historical cost of \$20,000 in *Healthy Greens*'s statement of financial position with a Note 4 showing its interest rate and its maturity date. Reporting the loan at \$20,000 is faithfully represented with the loan contract, which is complete, showing all the information necessary to help users understand it, neutral because it is free from bias and not manipulated in any way to mislead users (Also, it was prepared by the bank and not *Healthy Greens*), and it will be free from error with no omissions or estimations. This is all shown through the loan contract, which is verifiable because different and knowledgeable people can reach a consensus that this is faithfully reported.

⊗ With the amount of loan

The student has justified why the loan meets the past, present and future definition requirements of a liability and explained faithful representation in the context of the loan and justified why the loan is a non-current liability.

QUESTION TWO

The student has justified all parts of the accounts receivable as it relates to the characteristics of an asset and explained that the invoice is verifiable which makes it a reliable measure.

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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:

from Healthy Greens.

- 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 because it arises from a past transaction when restaurants and hotels ordered salad greens and other vegetables on credit. It is under the present control of Healthy Greens because the future economic benefit from accounts receivable will flow to Healthy Greens only as they have exclusive right to the money. An invoice will be sent to customers and it will be between them and Healthy Greens only. Accounts receivable will result in an inflow of future economic benefits when the customers pay off their accounts, this will generate income and result in cash being received by Healthy Greens. It is highly probable (greater than 50%) that future economic benefit will flow to Healthy Greens as they have supplied customers with goods and an invoice will be sent, which the customers are legally obliged to pay. Also, they would want to maintain a good relationship with Healthy Greens so they can be supplied with salad greens and other vegetables on credit in the future, so it is highly likely they will pay their invoice and assets (in the form of cash/bank) will flow to Healthy Greens. The amount of accounts receivable is reliably measured which shows the cost which can be easily verified.

The student has justified all parts of an expense and explained how the reporting of accounts receivable less allowance for doubtful debts is relevant.

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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.

Doubtful debts is an expense because it decreases economic benefit due to a decrease in asset - accounts receivable because it means the customers will not pay their accounts. This decreases equity due to a decrease in profit for the year and it is not a distribution to Maia, the owner. Therefore, doubtful debts will be reported in Healthy Green's income statement as an expense.

Information is relevant if it is capable of influencing the decision making of the user of the information. Relevance has been applied by having a Note 1 box in the Statement of financial position so that it is listed separately and users can easily make decisions because by nature, it is relevant to see how much allowance for doubtful debt has been subtracted from accounts receivable so the owner, for example, can make decisions on how to decrease the amount of doubtful debts. Also, it has a predictive role in helping Maia predict the amount of cash they will receive in the next accounting period, by subtracting the amount that probably won't be paid by some debtors, so they have an accurate indication of the future economic benefits that will flow to Healthy Greens in the next accounting period.

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In the future

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QUESTION THREE

The student has justified the diesel fuel (\$200) is revenue expenditure and reported in the income statement and correctly explained the entity concept making it clear that the \$50 is reported in the drawings in the balance sheet.

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.

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

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

Sales  
GST  
AR

(a) Justify how Maia will report the \$250 spent on diesel in the financial statements of Healthy Greens. In your answer, explain:

Incurred in order to earn income

- 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.

The \$200 spent on diesel is revenue expenditure because it is a re-occurring cost that will bring economic benefits to Healthy Green for the year only (current accounting period) because it will be used to deliver products to customers. It will be classified as an expense in Healthy Greens' income statement and will affect the net profit for the year calculation. The entity concept states that the financial affairs of Healthy Greens must be kept separate and distinct from the financial affairs of Maia and other entities, to provide the most accurate information in Healthy Greens' statements that relates to their business only. Therefore, the \$50 Maia used for her personal trip will be subtracted from capital as drawings in the statement of financial position of Healthy Greens to accurately report equity. The \$50 spent on diesel will not be reported in the income statement of Healthy Greens because it is Maia's personal expense and not Healthy Greens' expense. This is so users of these statements can make decisions based on relevant information relating to Healthy Greens only.

(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 concept states that the effects of transactions are recognised when they occur and reported in the financial statements to which they relate. The total of \$34.50 will be added to the salad green sales on the income statement of Healthy Greens to report the total sales for the current period as products have been delivered but the money has not been received yet. It will also create a ~~current~~ current asset in Healthy Greens' statement of financial position - Accrued Income - to report an inflow of future economic benefits in the form of cash (bank) when Three Brothers Hotel pays.

their account to Healthy Green in the next accounting period. This ensures that assets and liabilities are accurately reported. GST will also increase by \$4.50 to account for the GST as part of the sales.

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QUESTION NUMBER

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

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