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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.

Merit

TOTAL

15

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QUESTION ONE

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Wiremu owns *Beachsplash*, a kayak hire shop at Whatuwhiwhi 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 Beachsplash's cash flow statement is to show their cash sales and expenses for a period of time.

The cashflow statement summary of Beachsplash's illustrates monetary measurement. Monetary measurement states that all transactions are to be recorded in the currency relevant to the business and as Beachsplash is from New Zealand

they are recording receipts and payments in the NZ dollar //

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Comparability is the characteristic that applies the action of identifying similarities and difference and trends in information that has been prepared consistently. As we can see from the summary Beachsplash's information has been prepared consistently over 2 years and it shows that they have had a big increase in closing cash value between 2014 and 2015 //

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**.

The paddleboards are reported as assets because there was a past transaction of which Beachsplash purchased the boards on credit with invoices as proof. Beachsplash has present and exclusive control over the paddleboards as they are the only business that can use them and the boards will bring in future economic benefit to Beachsplash when customers hire them out, increasing the asset bank //

The recognition criteria states that the value of the asset is measured reliably as the transaction and the paddleboards cost of ~~\$15,000~~ \$15,500 will be written on a source document, (the invoice) //

The paddleboards are reported as a non-current asset because their useful lifetime is expected to last over one year, the future economic benefit should still be flowing in after a year.

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 is depreciating an asset at a set amount annually that stays the same (eg 20% per annum).

The units of use method is used by dividing an assets cost by its useful lifetime in relevant units and annual depreciation depends on the amount of usage.

Straight-line is appropriate for the Billboard because it will have the same loss of future economic benefit every year. The depreciation on the Billboard every year will be the same as the billboard will be used the same all the time, and it will only wear and tear with the weather. Therefore to record the depreciation of billboard in a straight line depreciation method is more useful and accurate than the other method.

Units of use is an appropriate method of depreciation for the paddleboards as depending on how much they are used by customers, the amount of depreciation may be more or less.

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**.



- (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.

Historical Cost is recording transactions at their original purchase price. This relates to the footpath sign because Wiremu will record it at the price of \$250 //

~~Materiality~~ Materiality is the omission or mis-statement of information that may influence a decision. //

Materiality is measured on the size of information. //

Because the sign only cost Wiremu \$250 in comparison to the \$8,000 Billboard we would say that the footpath sign isn't material. //

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M5

QUESTION THREE

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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.

Board Hire and lessons is an income for Beachsplash because there will be an increase in the accounts receivable. This will cause an increase ~~in equity~~ in profit and therefore equity. The amount received of \$500 will not be a contribution of the owners it will be from the school. //

Faithful Representation states that information reported must be complete, neutral, and free from error to be faithful. By reporting the board hire and lessons as income of \$500 the information is complete, neutral, and free from error so therefore faithful. //

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.

- (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 deposit of \$1000 was ~~reported~~ reported in the statement of financial position under income in advance in current liabilities this is because following the accounting concept of accrual basis transactions must be reported in the period of which they relate to. As the lessons are in the next financial year they are reported as income in advance //

Although the deposit was included in the account paddle board hire and lesson income, we have to subtract it from the \$28,000 because the deposit doesn't relate to the current financial year for Beachsplash //

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

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QUESTION
NUMBER

Annotated Exemplar

Merit exemplar 2016

Subject: Accounting		Standard: 91174	Total score: 15
Q	Grade score	Annotation	
1	M5	<p>1 (a) The candidate has identified a purpose of the cash flow statement, explained how the monetary measurement has been illustrated in the cash flow statement, and described comparability with an attempt to link to the context of <i>Beachsplash's</i> cash flow statement.</p> <p>1 (b) The candidate has correctly described why the paddle boards are an asset using the characteristics of past transaction, present control and future economic benefit. The candidate has explained how the recognition criteria is being met for reliability and has described that the paddle boards are a non-current asset.</p>	
2	M5	<p>2 (a) The candidate has accurately explained the straight-line and units-of-use methods of depreciation, and explained why the straight-line method is appropriate for the billboard.</p> <p>2 (b) The candidate has described historical cost in the context of the footpath sign, the meaning of materiality, and how the footpath sign is immaterial in amount.</p>	
3	M5	<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, net profit increasing equity, and not a contribution by the owner but the school. The candidate has described faithful representation by making reference to 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 the deposit doesn't relate to the current financial year for <i>Beachsplash</i>. The candidate has described the accrual basis concept in the context of the Statement of Financial Position by describing how the current liability income received in advance will increase, but has not explained why.</p>	