NZQA

NEW ZEALAND QUALIFICATIONS AUTHORITY
MANA TOHU MĀTAURANGA O AOTEAROA

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Level 2 Accounting, 2018

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

2.00 p.m. Wednesday 14 November 2018
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 2–8 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.

TOTAL

Note: This examination is based on *Awa Motel*.

Awa Motel is a sole proprietor business owned by Max and registered for GST on the invoice basis. *Awa Motel* is located on a busy highway, and many guests stay only one or two nights. Motel guests can purchase breakfast for an additional charge.

QUESTION ONE

Max plans to upgrade the bathrooms in a number of the motel units in the coming year. He is considering selling the shares in *Mercury Limited* that *Awa Motel* owns to help fund the upgrades.

The following information relates to the shares in *Mercury Limited*.

Awa Motel
Statement of Financial Position as at 31 March 2018 (extract)

	Note	$
Investment		
Shares in *Mercury Limited*	1	12 000

Notes to the financial statements (extract)
1.   The shares in *Mercury Limited* have a current market value, considered to be fair value, of $15 840.

Statement of Accounting Policies (extract)
Investments
Investments are stated at cost.

(a)   Explain the purpose of the Statement of Accounting Policies in terms of understandability. In your answer, include reference to the extract from the Statement of Accounting Policies.

(b) Justify, in terms of historical cost and relevance, why the investment asset note to the financial statements discloses the current market value of the investment. In your answer, refer to relevant figures in relation to the investment asset and explain:

- how historical cost is applied to reporting the investment asset in the Statement of Financial Position

- why the investment asset meets the following extract from the asset definition "an asset is a resource controlled by the entity," as in The New Zealand Framework 2011

- why the current market value, rather than the historical cost, is relevant to Max in relation to his plans to upgrade the bathrooms.

QUESTION TWO

> Max gives his friend Pam free accommodation at *Awa Motel*, including free breakfast, when she comes to visit her grandchildren, who live nearby. Max's accountant records as drawings the cost of the breakfast supplies and cleaning the motel unit Pam uses. Motel cleaning includes cleaners' wages and cleaning supplies used.

(a)   Justify why the costs associated with Pam receiving free accommodation are reported as drawings rather than as an expense of *Awa Motel*. In your answer, refer to:
   •   the entity concept
   •   the following part of the expense definition "…not a distribution to owners," as in The New Zealand Framework 2011.

> Most of Max's regular guests are overnight travellers who do not pay for breakfast. Max has become concerned that offering breakfast is not as profitable as it was in the past.

(b)   Justify why reporting the cost of free breakfasts provided to Pam as drawings aids comparability of *Awa Motel*'s breakfast profits. In your answer, explain:

- the purpose of determining the profits from breakfast sales separately from motel room sales
- why comparability of profits from breakfast sales is important for Max
- why reporting the cost of free breakfasts as drawings ensures that the profits from breakfast sales are comparable.

QUESTION THREE

Max accepts bookings for *Awa Motel* up to one year in advance. All bookings require a minimum 10% deposit to secure the booking. Regular guests usually pay in full when making their booking. *Awa Motel* guests are able to purchase breakfast for an additional charge.

The following information relates to motel room sales and breakfast supplies for the year ended 31 March 2018.

Awa Motel
Trial balance (extract) as at 31 March 2018

	$		$
Cost of breakfast supplies sold	18 000	Motel room sales	300 000
Inventory – breakfast supplies	3 200		

Additional information
- Motel room sales received in advance $28 750 including GST
- Included in inventory – breakfast supplies is some past-use-by-date cereal with a cost of $500 and a net realisable value of $0. The inventory is to be written down.

The New Zealand Framework 2011 includes the following

- an essential characteristic of a liability is that the entity has a present obligation
- settlement of a present obligation may occur in a number of ways, for example, by:
  (a) payment of cash;
  (c) provision of services.

(a) Justify why motel room sales received in advance will be reported as a current liability.
In your answer, explain why the motel room sales received in advance:
- are a present obligation
- meet the probable aspect of the recognition criteria for a liability
- are a current liability, rather than a non-current liability.

Extract from The New Zealand Framework 2011, *Expense* definition:

Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets that result in decreases in equity.

(b)   Justify why the breakfast supplies inventory written down is an expense for *Awa Motel*.
In your answer, explain:
   •   how the above extract from the definition of an expense is applied
   •   why the $500 meets the reliable measure aspect of the recognition criteria for an expense.

QUESTION NUMBER

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