Achievement Standard 90976

Demonstrate understanding of accounting concepts for small entities

ACCOUNTING 1.1

Externally assessed 3 credits

Accounting 90976 (Accounting 1.1) involves the recognition, definition and application of the conceptual basis of accounting, applied to community organisations and sole proprietors.

There is one criterion in Achievement Standard 90976 (Accounting 1.1), which is divided into the following five main topics.

- Nature of accounting – users and uses of financial information, features of entities, specialised areas of accounting.
- The purpose of financial statements.
- The financial elements – assets, liabilities, equity, income, expenses. Depreciation and capital or revenue expenditure are included here.
- The accounting concepts – accounting entity, monetary measurement, going concern, period reporting, accrual basis and historical cost.
- The accounting equation.

In this chapter, each section has questions from previous examination papers to give you a good idea of the questions you might be asked. At the end of the chapter, two exam papers are included in their entirety.

Nature of accounting

Accounting is a way of communicating financial information so that interested parties can make informed decisions. Financial information is used by internal and external users. A number of people are interested in various uses of accounting information and financial statements.

Cash budget
Predict the movements of cash received and paid for over a period of time

Income Statement
Calculates profit for a period of time

Financial statements

Statement of Financial Position
Shows the value of assets, liabilities and equity at a point in time

Statement of Cash Flows
Shows movement of cash and change in bank account

Balance Sheet is an alternative name for *Statement of Financial Position.*

Accounting assists the decision makers in a business.

Internal users (Management Accounting)

- Managers/Supervisors – cost centres, cost of goods sold, profitability, budgets vs actual results.
- Employees – job security, ability to pay wages.
- Members of a club or society – to see how their subscriptions are being spent.

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External users (Financial Accounting)

- Owners of a business – to assess past performance of the business and to plan for the future.
- Creditors – cash position of business (i.e. can they repay debt?).
- Inland Revenue Department (IRD) – for payment of taxes, including GST.
- Bank Managers – for assessing the risk of making loans or bank overdrafts, and assessing security for loans.
- Other users – e.g. Statistics New Zealand.

Accounting is used to measure the profit of a business (an entity) through the Income Statement, and to show what the business controls (assets) and is obliged to repay (liabilities) through the Statement of Financial Position.

The Accountant

Collects data: normally done by an accounting clerk or technician who collects and records all daily transactions, such as journals and GST returns.	**Measures performance:** by classifying, analysing and interpreting the accounting information.	**Reports information:** to interested parties to help in their financial decision making.

Accountants normally specialise in the following:

- Financial Accounting (or Chartered Accounting) – analysing and interpreting the financial information to assist in financial decision making.
- Management Accounting – co-ordinating the flow of financial information from the business's operation, i.e. preparing internal reports and measuring performance, e.g. budget preparation.
- Cost Accounting – controlling costs of producing the goods or services a business sells.
- Taxation Accounting – the calculation and payment of tax, and advice on tax issues.
- Auditing – independent check on business's financial records to ensure accuracy and reliability, i.e. 'a true and fair view'.

Different entities

Accounting is used by individuals, households, community organisations, sole proprietors, partnerships, and companies. Each of these groups has different features or characteristics and thus has different needs for accounting services.

Features	Individual or household	Unincorporated society	Incorporated society	Sole proprietor
1. Ownership	Individual, or by household consensus	Two or more members	Club members: 15 or more members	One person: proprietor
2. Management	Individual, or by household consensus	Elected Board Committee	Elected board of members	The owner is usually the manager
3. Advantages of this form of ownership	Complete ownership and control. Very informal and flexible	No audit fees or set-up costs	Limited liability. Can receive funds from Lottery Board, etc.	Easy to set up, complete ownership, runs the business – complete control
4. Disadvantages of this form of ownership	Unlimited liability. Conflicts between flatmates or within families are possible	Unlimited liability	Set-up and audit costs	Unlimited liability, tied to business (holidays difficult), management is difficult for one person, restricted ability to expand

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Achievement Standard 90978

Prepare financial statements for sole proprietors

ACCOUNTING

1.3

Externally assessed 5 credits

Achievement Standard 90978 (Accounting 1.3) involves the preparation of financial statements for sole proprietors registered for GST on the payments basis that are:

- service businesses and/or
- trading businesses that use a periodic inventory system.

There will be combinations of a full financial statement and financial statement extracts, including balance-day adjustments.

Preparation of financial statements for sole proprietors

To achieve this Standard you need to be able to prepare financial statements, or extracts, from the information provided. To achieve 'Merit' you need to also include balance-day adjustments where the amounts are provided. For 'Excellence', in addition to the Merit requirement, you need to calculate numbers for the adjustments and ensure you have no foreign items. You must never abbreviate in financial statements.

You are required to prepare four financial statements. These can be in their entirety, or extracts. They are:

- Income Statement for a service entity
- Income Statement for a retail entity
- Statement of Financial Position (Balance Sheet)
- Cash Budget.

Before you prepare the financial statements on balance day, additional information must be accounted for. This happens effective on balance day.

The last day of the financial year is known as **balance day**. Balance day is normally, but not necessarily, 31 March each year. On balance day, the Income Statement and Statement of Financial Position are drawn up from information stored in the ledger accounts and summarised in the trial balance. On balance day there are transactions which may not have been completed, such as those where the business owes or is owed money for income and expenses.

There are four groups of transaction that need to be accounted for.

- Expenses and Income must be allocated to the correct accounting period.
- On balance day, credit transactions must be accounted for (the business records cash transactions as they happen).
- Other transactions (e.g. stocktaking, depreciation, and drawings of goods) must be brought into the accounts.
- Some expenses must be split according to classification.

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1.3

Expenses and Income

	Expenses for the period		Income for the period	
	Too much paid	**Not enough paid**	**Too much received**	**Not enough received**
The Double Entry is	Prepayment This is an asset **(DR)**	Accrued expenses This is a liability **(CR)**	Income in advance This is a liability **(CR)**	Accrued income This is an asset **(DR)**
	Need to reduce the expense **(CR)**	Need to increase the expense **(DR)**	Need to reduce the income **(DR)**	Need to increase the income **(CR)**

Incorporating balance-day adjustments

You will be given some additional information to deal with, such as the example that follows.

Invoices on hand for purchases/supplies $1 840, including GST.	Increase purchases/supplies expense account by $1 600 in Income Statement. Decrease GST payable account by $240. Add current liability (accounts payable) to the Statement of Financial Position $1 840.
Invoices on hand for sales/fees $3 680, including GST.	Increase sales/fees revenue account by $3 200 in Income Statement. Increase GST payable account by $480. Add current asset (accounts receivable) to the Statement of Financial Position $3 680.
The business has purchased a vehicle (or any fixed asset) on credit $9 200, including GST.	Increase vehicle asset account by $8 000. Decrease GST payable account by $1 200. Add current liability (accounts payable) to the Statement of Financial Position $9 200.
Note: The three preceding adjustments are the only ones involving GST. The adjustments following do not require GST calculations.	
Inventory on hand (closing inventory) $2 000.	Relates to the value of inventory at the end of the period – becomes the closing inventory figure in the Income Statement. Inventory figure shown as current asset in the Statement of Financial Position.
Wages or interest owing by business on balance day.	Increase the expense by the amount stated in Income Statement. Add current liability (accrued expenses/expenses due) to the Statement of Financial Position.
Interest or dividends owing to business on balance day.	Increase the income by the amount stated in Income Statement. Add current asset (accrued income/income due) to the Statement of Financial Position.
Items received in advance, e.g. rent, fees.	Decrease the income by the amount stated in Income Statement. Add current liability (income in advance) to the Statement of Financial Position.
Amounts paid in advance for next year by the business, e.g. insurance.	Decrease the expense by the amount stated in Income Statement. Add current asset (prepayments) to the Statement of Financial Position.

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Questions: Preparation of financial statements

Question One

Year 2018
Ans. p. 115

1.3

Resource

Workout Works is a fitness and exercise gym owned by Wallace. It offers a range of group classes and individual workouts. In addition to the gym facilities that members pay a membership fee to use, *Workout Works* also hires out equipment to members to use in their own homes.

The following Trial Balance and additional information relate to *Workout Works* for the year ended 31 March 2018.

Workout Works
Trial Balance as at 31 March 2018

	$		$
Advertising	3 800	Accumulated depreciation on exercise equipment	9 000
Drawings	44 500	Accumulated depreciation on gym fixtures and fittings	4 320
Exercise equipment	56 000	Accumulated depreciation on office equipment	1 200
Fitness instructors' wages	70 000	Bank overdraft	2 000
Goodwill	12 000	Capital	79 520
Gym cleaning	26 000	Dividends received	300
Gym fixtures and fittings	41 600	Equipment hire received	8 000
Gym rent	64 000	GST payable	3 160
Gym supplies on hand	2 800	Loan (due 2026)	45 000
Gym supplies used	12 000	Membership fees received	240 400
Interest on loan	2 700		
Office equipment	6 200		
Office expenses	15 000		
Office salaries	18 500		
Other gym expenses	7 300		
Petty cash	100		
Shares in *Bodyfix Ltd*	8 000		
Stationery	800		
Telephone & Internet	1 600		
	$392 900		$392 900

Additional Information

- Office expenses paid in advance, $320 excluding GST
- Interest on loan owing on balance day, $280
- Equipment hire received in advance, $850 excluding GST
- Depreciation on exercise equipment, $5 400 per year
- Depreciation on gym fixtures and fittings is 12% p.a. straight line
- Depreciation on office equipment is based on a useful life of 10 years and a residual value of $700
- Invoice received on 31 March 2018 for purchase of new exercise equipment, $5 543 including GST
- Invoices issued on 31 March 2018 for membership fees received total $1 656 including GST.

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Part A: Income Statement

Refer to the preceding **Resource** to answer this question.

Prepare a fully classified Income Statement for *Workout Works* for the year ended 31 March 2018.

Classify the expenses as:

- Gym costs
- Administrative expenses
- Finance costs.

Note: Do NOT use abbreviations.

Workout Works

Income Statement for the year ended 31 March 2018

	$	$	$

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Achievement Standard 90980

Interpret accounting information for sole proprietors

ACCOUNTING

1.5

Externally assessed 4 credits

Achievement Standard 90980 (Accounting 1.5) involves interpreting information for a sole proprietor or sole proprietors. These are limited to service businesses and/or trading businesses that use a periodic inventory system and that are registered for GST on the payments basis.

A calculator is required, as you will be required to calculate the analysis measures.

Ratio and percentage formulae will be provided. Round calculations to either 1 or 2 decimal places as instructed.

Ratios and percentages

Once the financial statements have been prepared, it is important to analyse them to allow sound decisions to be made for the future.

Analysing information involves calculating analysis measures – formulae will be provided.

Interpreting information involves:

- explaining analysis measures
- recognising satisfactory/unsatisfactory ratios, percentages or trends
- explaining reasons for trends
- making, justifying and stating the consequences of recommendations
- explaining relationships between analysis measures.

Analysis measures are used to measure:

- profitability – mark-up %, gross profit %, expenses %, profit %, percentage changes, comparisons of dollar amounts
- liquidity – current ratio, liquid ratio
- financial stability – equity ratio.

Income Statement

The following examples are for *Skateboys Rollerblade Club*, whose information is shown in the table alongside.

Note: Net sales is calculated by Sales – Sales returns

Skateboys Rollerblade Club **Income Statement** **for year ended 31 March 2011**		
Net sales		132 000
Less Cost of goods sold		108 000
Gross profit		24 000
***Less* Expenses**		
Distribution costs	3 300	
Administrative expenses	2 640	
Finance costs	1 320	7 260
Profit for the year		$16 740

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Mark-up percentage

Mark-up is the extra added on to the cost of goods sold to obtain the selling price. Mark-up percentage measures the percentage of cost price of the inventory which is added on to the inventory cost price to calculate the selling price.

Selling price = Cost price + Mark-up, e.g. cost price is $10.00, add mark-up $5.00, selling price is $15.00.

$$\textbf{Mark-up percentage} = \frac{\textbf{Gross profit}}{\textbf{Cost of goods sold}} \times \frac{\textbf{100}}{\textbf{1}} \qquad \textit{Example:} \ \frac{24\ 000}{108\ 000} \times \frac{100}{1} = \textbf{22.2\%}$$

Mark-up percentage may be higher or lower than desired, due to the wrong mark-up being placed on purchases, or incorrect stock take.

Mark-up percentage may be lower due to goods being stolen.

Gross profit percentage

$$\textbf{Gross profit percentage} = \frac{\textbf{Gross profit}}{\textbf{Net sales}} \times \frac{\textbf{100}}{\textbf{1}} \qquad \textit{Example:} \ \frac{24\ 000}{132\ 000} \times \frac{100}{1} = \textbf{18.2\%}$$

The gross profit percentage measures the percentage of sales left as gross profit, after accounting for cost of goods sold. This is used to cover operating expenses and make a profit.

The higher the mark-up, the higher the gross profit. Gross profit needs to be sufficient to cover operating expenses and drawings.

Gross profit variances can be caused by theft of stock, incorrect stock takes, or by a deliberate reduction in price to increase sales volume.

Expenses percentages

Different categories of expenses can be compared with net sales to determine how different parts of a business are performing; e.g., if selling expenses were increasing, the business would hope sales were increasing similarly. Or if administration expenses percentage is decreasing, it could mean the administration of the business is becoming more efficient.

$$\textbf{Distribution cost percentage} = \frac{\textbf{Distribution costs}}{\textbf{Net sales}} \times \frac{\textbf{100}}{\textbf{1}} \qquad \textit{Example:} \ \frac{3\ 000}{132\ 000} \times \frac{100}{1} = \textbf{2.5\%}$$

$$\textbf{Administrative expenses percentage} = \frac{\textbf{Administrative expenses}}{\textbf{Net sales}} \times \frac{\textbf{100}}{\textbf{1}} \qquad \textit{Example:} \ \frac{2\ 640}{132\ 000} \times \frac{100}{1} = \textbf{2\%}$$

$$\textbf{Finance costs percentage} = \frac{\textbf{Finance costs}}{\textbf{Net sales}} \times \frac{\textbf{100}}{\textbf{1}} \qquad \textit{Example:} \ \frac{1\ 320}{132\ 000} \times \frac{100}{1} = \textbf{1\%}$$

An expense percentage measures the percentage of sales used to pay for / incurred by that particular expense or group of expenses.

Profit percentage

$$\textbf{Profit percentage} = \frac{\textbf{Profit for the year}}{\textbf{Net sales}} \times \frac{\textbf{100}}{\textbf{1}} \qquad \textit{Example:} \ \frac{16\ 740}{132\ 000} \times \frac{100}{1} = \textbf{12.7\%}$$

Profit percentage shows how much of each dollar of sales is profit; in the example, for every $1.00 of sales, 12.7 cents is profit retained in the business after all expenses have been accounted for.

A higher net profit percentage is not necessarily all good – a corner dairy has a high net profit percentage compared with the net profit percentage of supermarkets, which have low net profit percentages in order to generate more turnover and thus more dollar profits.

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Question One

Year 2018
Ans. p. 119

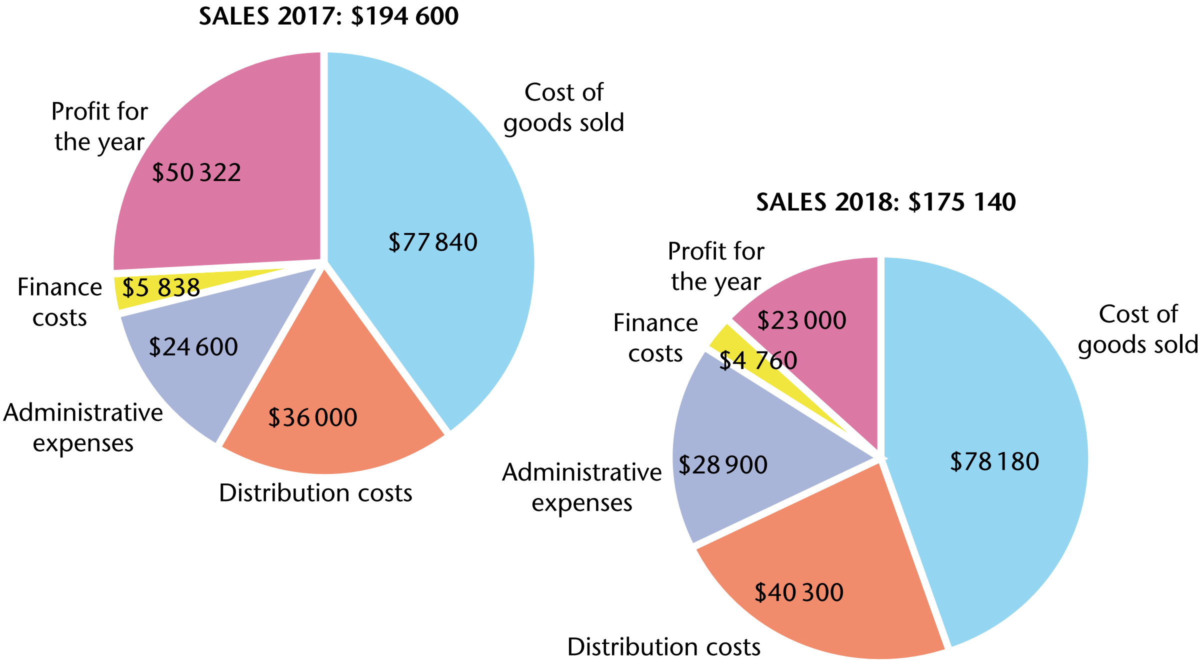
Resource One

Tony owns *Fashionz*, a sole proprietorship business specialising in selling popular clothing to teenagers. *Fashionz* has been operating for many years and this year started selling shoes and other fashion accessories, as well as clothes.

In the middle of this financial year, a new shop, *Top to Bottom*, opened in the same neighbourhood, also selling trendy clothing. Tony increased *Fashionz*' advertising to help compete with the new store.

Resource Two

The graphs below show the income and expenses for *Fashionz* for the years ended 31 March 2017 and 31 March 2018.



Resource Three

The table below shows the assets, liabilities, and equity for *Fashionz* as at 31 March 2017 and 31 March 2018.

Fashionz **Assets, Liabilities, and Equity as at 31 March**		
	2017	**2018**
	$	**$**
Bank	3 480	1 860
Inventory	7 200	9 080
Prepayments	120	180
Property, plant, and equipment	220 000	222 000
Accounts payable	2 210	3 010
Accrued expenses	360	320
GST payable	940	990
Loan (fixed @ 9%, due October 2028)	65 000	59 000
Equity	162 290	169 800

Tony has not invested any money into *Fashionz* in recent years, and does not have any spare cash to do this in the near future.

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1.5

Part A

Refer to **Resources One** and **Two** to answer this question.

a. Complete the Analysis Measures chart below for *Fashionz* for the year ended 31 March 2018.

Note: Percentages should be rounded to the nearest ONE decimal place.

Analysis Measures chart for *Fashionz*		
Analysis Measure	**2017**	**2018**
Mark-up %	150.0%	124.0%
Gross profit %	60.0%	
Distribution cost %	18.5%	
Percentage change in sales	7.2%	

b. Write a report to explain to Tony the change to sales for *Fashionz*.

Your report should include:

- the meaning of the gross profit percentage of 60.0% for 2017
- a possible reason for the trend in sales between 2017 and 2018 (percentage change in sales)
- a justified recommendation to improve sales next year, taking into consideration everything that has occurred this year.

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Answers and explanations

The 'Achieved' A, 'Merit' M, and 'Excellence' E, ratings given with the answers to NCEA questions for the externally assessed Achievement Standards chapters are based upon the professional judgements of the author.

A The answer is required to be correct and complete to gain 'Achieved' for that part of the overall question.

A ($\frac{5}{7}$) To gain 'Achieved', the candidate must score 5 correct responses out of the total of 7 for the question. Responses could be explanations, entries, balances, calculations, etc., or any combination of responses.

M The answer required is to be correct and complete to gain 'Merit'. Candidate gains 'Merit' or nothing.

M ($\frac{6}{7}$) To gain 'Merit', the candidate must score 6 correct responses out of 7 for the question.

M/E Answer is E level, but M standard of answer possible – A possible if explanation not fully applied to the examples.

E ($\frac{7}{7}$) To gain 'Excellence' the candidate must score 7 correct responses out of 7 for the question.

Achievement Standard 90976 (Accounting 1.1): Demonstrate understanding of accounting concepts for small entities

1.1 Nature of accounting

p. 5

Question One

a. To calculate the profit for the period for *Yours to View*. / To calculate the income and expenses for *Yours to View* for the period and to compare these results with those of previous years. (A)

b. Brian gets to make all the decisions. / Brian gets to keep all the profits of *Yours to View*. (A)

c. This means that if *Yours to View* (i.e. the business) gets into financial difficulty and cannot meet its debts, Brian (i.e. the owner) can be forced to sell personal assets to repay the business's debts. (M/E)

d. (1) Getting a bank loan.
(2) Brian (i.e. the owner) could invest more money in the business. (A)

e. ii. E iii. A iv. B v. F vi. C (A)

1.1 Financial elements and depreciation

p. 8

Many questions in this section can be graded as either 'Merit' or 'Excellence'. Students will achieve a 'Merit' grade if their answer defines concepts, but there is insufficient linkage of the concept with the context of the question. An 'Excellence'-level answer is one that fully integrates examples that are relevant to the context of the question into the definition, and so clearly answers what has been asked.

Question One

Part A

a. i. Expenses: Advertising; Interest on loan; Telephone; Wages (A = any 3; no abbreviations used)

ii. Sources of income: Dividends; Interest received; DVD rentals; Sales (A = any 3; no abbreviations used)

b. Video game rental is an income for *Yours to View* because there will be an increase in the asset 'Bank' when the customers pay to hire the video games. Video game rental increases the profit, which increases the equity, and the rentals are not a contribution by the owner / by Brian. (M, E)

c. *Yours to View* paid for the wide-screen television in the past. The TV is a resource (currently) *controlled* by the entity as they have it locked in their shop and only they decide what is shown on the TV.

The wide-screen television will provide future economic benefit for *Yours to View* because the customers will see the DVDs playing and this will encourage them to hire more DVDs, and thus increase the DVD rental income, and the Bank account when paid for. (A/M/E)

d. *Yours to View* depreciates the wide-screen television each year to systematically allocate the loss in future economic benefit this year / to systematically allocate the cost of the television over its useful life. (NOT loss in value.) (M/E)

e. Wages paid to staff is a decrease in assets as the asset 'Bank' will decrease as the money is paid to *Yours to View* employees for the work done.

The wages decreases equity because paying wages causes a decrease in profit for *Yours to View* which in turn decreases the equity and the wages are not a distribution to Brian the owner. (M/E)

Part B

a. i. Capital expenditure.
ii. Capital expenditure.
iii. Revenue expenditure.
iv. Revenue expenditure. (A – 3)

b. *Aronui Marae* received the money in the form of a loan (from a bank) at some time in the past.

Aronui Marae is presently obliged to (they know now that they have to) repay the money to the bank / they have a contract that states how much they currently have to repay and there will be a future sacrifice of assets when *Aronui Marae* repays the loan which decreases their asset 'Bank'. (A/M/E)

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1.1 The accounting equation

p. 12

Question One

a.

Ashleigh's Performance Studio accounting equation								
	Bank	Accounts receivable	Musical equipment	Expenses	Accounts payable	Loan	Equity	Income
A	+10 000					+10 000		
i.	+1 500							+1 500 ✔ (A)
ii.		+2 000						+2 000 ✔ (A)
iii.	+200						+200	✔ (A)
iv.	–550			+50		–500		✔ (M)
v.	–80				–90			+10 ✔ (M)

b. i. Paid studio electricity $200; paid for musical supplies $200 (NOT bill / account); (paid any relevant expenses for a performance studio). ✔ (A)

ii. Ashleigh took $300 cash for personal use (*or* Cash drawings $300 *or* Owner paid personal expenses with business money $300) ✔ (A)

iii. Purchased new stereo (*or* other musical equipment) costing $900. Paid $100 deposit and put the rest on credit. ✔ (M)

iv. The business received $70 in full settlement of $80 account (giving a $10 discount). ✔ (M)

v. Sold musical equipment (e.g. old stereo) which had originally cost $250, for $300 on credit (making a gain of $50 on the sale). ✔ (M)

Question Two

a. Assets will increase as van will increase in *Merv's Movers'* accounts by $15 000. (A) Liabilities will increase as *Merv's Movers* purchased the van on credit, so accounts payable increases by $15 000. (A)

b. Assets will decrease by $360 as the asset 'Bank' will decrease when *Merv's Movers* pays its workers. (A) Expenses will increase by $360 as Wages increase. (A)

c. Asset 'Bank' will increase by $3 200. (A) Income will increase by $3 200 as Fees received will increase. (A)

d. Assets will decrease as Bank will decrease by $2 300. (A) Equity will decrease as Drawings will increase by $2 300. (A)

(A = element increasing or decreasing, M = A plus correct amount and account)

1.1 Accounting concepts

p. 15

Many questions in this section can be graded as either 'Merit' or 'Excellence'. Students will achieve a 'Merit' grade if their answer defines concepts, but there is insufficient linkage of the concept with the context of the question. An 'Excellence'-level answer is one that fully integrates examples that are relevant to the context of the question into the definition, and so clearly answers what has been asked.

Question One

Part A

a. Accounts Payable, Accrued expenses, GST payable, Loan
(3 of = A)

b. Assets: *Cakes & Cookies* asset bank decreases $760

Expenses: *Cakes & Cookies* expense Interest on Loan increases $260

Liabilities: *Cakes & Cookies* liability Loan decreases $500
(2 = A, 3 = M)

c. *Cakes & Cookies* will report the decorating tools as an asset in the Statement of Financial Position at $6 000 as this is the original cost that *Cakes & Cookies* has paid for the tools (original acquisition cost / original purchase cost).
(A = tools and original cost, M = Achieved plus *Cakes & Cookies*, E = Merit plus Statement of Financial Position and $6 000)

d. The new decorating tools are an asset for *Cakes & Cookies* because it purchased the tools online in the past. *Cakes & Cookies* has present control over the use of the tools and has exclusive rights to use them / decide how they will be used to make cookies / are kept locked in its shop so others can't access them. The tools will be used to generate future economic benefit for *Cakes & Cookies* as it will use the tools to bake cakes/cookies which it will sell to customers who pay cash, increasing sales and bank.
(A = definition of asset for the tools (past transaction, present control, future economic benefit), M = Achieved plus two of the 'how' these features are met for *Cakes & Cookies*, E = fully explains the decorating tools are an asset for *Cakes & Cookies* by explaining how all three characteristics are met)

e. Depreciation is the systematic allocation of the asset over its useful life. This means that the $6 000 cost of the decorating tools is depreciated $1 500 every year for the four years in *Cakes & Cookies'* financial statements as this is their estimated useful life.
(A = definition of depreciation (first sentence), M = definition plus *Cakes & Cookies* and one of the figures to explain in context, E = definition plus *Cakes & Cookies* and all three figures to fully explain for the tools)

Part B

a. i. Equity = Assets – Liabilities

Assets: 1 350 + 500 + 7 200 + 860 + 34 000 = 43 910

Liabilities: 980 + 670 + 15 000 = 16 650

Equity = 43 910 – 16 650 = $27 260 (A)

ii. *Cakes & Cookies'* equity means that the residual value and assets minus liabilities is Charlie's equity $27 260 (M)

b. The cake decorators' wages are an expense for *Cakes & Cookies* because the wages decrease the asset bank when *Cakes & Cookies* pays its employees for decorating the cakes and cookies. The decorators' wages decrease profit which decreases *Cakes & Cookies'* equity, and the wages are not a payment/distribution to Charlie the owner. Therefore, the cake decorators' wages are an expense.
(A = decrease asset, decrease equity, not drawings, M = Achieved, plus wages, plus *Cakes & Cookies*, and one of the characteristics explained, E = full answer above)

c. The accounting entity states that the personal finances (financial affairs) of Charlie the owner must be kept separate and distinct from the finances of his business *Cakes & Cookies*. This means that Charlie must record this transaction in two ways. The $70 ingredients that Charlie took home are a personal expense of Charlie, not a business expense, so must be reported in the Statement of Financial Position as drawings. The remaining $330 ingredients are an expense for *Cakes & Cookies* so must be reported as a baking/distribution expense, Ingredients Used, in the Income Statement.
(A = definition of accounting entity (first sentence), M = report the $70 as drawings because it's a personal expense OR $330 business expense, E = explains, using the definition, the reporting of the $330 business expenses in the income statement (E) and the $80 drawings as a personal expense of Charlie in the statement of financial position (E).

Part C

a. The purpose of the income statement is to measure/calculate the incomes and expenses for the financial year and to calculate *Cakes & Cookies'* profit, in this case for the year ended 31 March each year. (A)

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