Achievement Standard 91174

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

ACCOUNTING

2.1

Externally assessed 4 credits

Concepts, notions and characteristics of accounting

Functions of accounting

Accounting is the processing of financial information for the users of that information in order to aid their business decision making.

Users of accounting information

Financial statements are prepared for users, in order to satisfy different needs. The users of financial statements and their needs include the following.

1. **Owners/Investors** – require information about the risk involved and their return from their investment in a business. Financial statements enable them to determine whether they should buy, hold or sell their investment in a business.
2. **Lenders** – are interested in seeing whether their loans and interest owing will be paid when these fall due, and need to assess the security over loan applications.
3. **Suppliers** – like lenders, are interested in seeing if amounts that the business owes them will be paid when due. They also use financial statements in order to help them make decisions about credit limits and terms of credit.
4. **Government** and its agencies (e.g. IRD) – the government is interested in resource use, therefore the activities of businesses. It also requires information for taxation purposes, for regulation and to determine national income and other statistics.

The following three users also desire access to the financial statements; however, it is unlikely they will have access if the business is a sole proprietorship. Therefore avoid using them in the examination if you can.

5. **Employees** – are concerned about the financial stability and the profitability of a business. Financial statements help them assess the business's ability to provide remuneration, retirement benefits, employment opportunities and stability. They do not often obtain access to the information.
6. **Customers** – are interested in the continuance of a business, especially if they feel the good or service provided by that business is of importance to them. They do not often get this information.
7. **Public** – the general public may require information on the contribution a business makes to the local economy. Details of interest include the number of people the business employs, and its patronage of local suppliers. Financial statements provide information to the public on the prosperity of a business and on its range of activities.

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2.1

Accounting concepts

At NCEA Level 2, 'accounting concepts' refers to: qualitative characteristics and their enhancements; financial elements; measurement base; assumptions and notions.

Qualitative characteristics

The New Zealand Institute of Chartered Accountants (**NZICA**) **New Zealand Framework** explains the nature of the rules that accountants should follow (ask your teacher, he or she should have a copy) and acts as an introduction to the **International Financial Reporting Standards** (IFRS) that accountants must follow in order to reach a true and fair view of the financial performance and position of the accounting entity they are reporting on.

Qualitative characteristics (the *minimum* requirements in terms of *quality* that accounting information must possess in order to be considered useful for the decision-making process) must be followed.

Qualitative characteristics

Relevance

Relevant information will influence decisions, provide **predictive value** (can be used to make predictions about the future, plan budgets, etc.) and have **confirmatory value** (provide feedback on past performance or trends). The information should also be **material**.

Materiality states that information that will influence decisions due to its **amount** or **nature** must be disclosed. Its omission or misstatement could influence decisions. Materiality makes it possible to expense small items (e.g. hand tools), or to total the value of all furniture, etc.

Faithful representation

Accounting information should reflect accurately the event it represents. **It must be complete, neutral**, and **free from error**.

Enhancing characteristics

Understandability

Accounting information should be presented in a way that is easily **comprehended** by those making use of the information.

Comparability

It must be possible to use accounting information to **compare accounting periods** to measure performance / make trend analyses / show similarities and differences. It should also be possible to use the information to **make comparisons with similar businesses**.

Timeliness

Information needs to be available in time to influence users' decisions.

Verifiability

When information is **verifiable**, it assures users that the information **faithfully represents** the account, event or transaction it represents. Different independent users will reach a consensus that the information is accurate.

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2.1

Questions: Conceptual basis of accounting

Question One

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

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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.

Part A

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.

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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.

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Achievement Standard 91176

Prepare financial information for an entity that operates accounting subsystems

ACCOUNTING

2.3

Externally assessed 5 credits

To gain the credits in Achievement Standard 91176 (Accounting 2.3), you will be required to have a full understanding of the financial statements that a sole proprietor, registered for GST on the invoice basis, would have prepared at the end of the financial year. The nature of the business conducted by the sole trader could be either:

- a service firm; *or*
- a trading firm (using a perpetual inventory system).

In addition to this, you need to be able to record any relevant balance-date adjustments, closing entries, and reversal entries in both the General Journal and General Ledger.

Balance-date adjustments

The life of a business is broken into periods of equal length, and as a result of the existence of differing accounting periods, some transactions occur during one period, but relate to a different accounting period – thus, balance-date adjustments must be prepared to ensure that transactions are accurately reported in the period to which they relate. Adjustments required at balance day include the following.

1. Accrued expenses

These are expenses incurred by the business (the service/goods have been received or used) but as at balance day they have not been recorded in the financial records of the business. The General Journal entry will *always* be:

Current liability in the Statement of Financial Position

DR	'Expense name' (e.g. wages)	xx	
CR	Accrued expenses		xx

2. Accrued income

These are income items that have been earned by the business (the service/goods have been provided) but as at balance day they have not been recorded in the financial records of the business.

The General Journal entry will *always* be:

Current asset in the Statement of Financial Position

DR	Accrued income	xx	
CR	'Income name' (e.g. dividends)		xx

3. Prepayments

These are expenses that have been paid for by the business (always GST-exclusive amount) but as at balance day they have not been incurred (used) by the business. The General Journal entry will *always* be:

Current asset in the Statement of Financial Position

DR	Prepayments	xx	
CR	'Expense name' (e.g. insurance)		xx

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Questions: Putting it all together

Question One

Year 2018
Ans. p. 113

2.3

Resource A

The following Trial Balance and additional information relate to *Awa Motel*, which is registered for GST on the invoice basis.

Awa Motel **Trial Balance as at 31 March 2018**			
	$		**$**
Accounts receivable	8 850	Accounts payable	4 200
Bad debts	400	Accumulated depreciation – furniture and fittings	22 000
Bank	5 200	Accumulated depreciation – laundry equipment	9 000
Cleaners' wages	37 200	Breakfast sales	41 000
Cleaning supplies used	12 700	Capital	421 000
Cost of breakfast supplies sold	18 000	Dividends received	2 000
Drawings	47 000	Gain on sale beds	300
Furniture and fittings	140 000	GST	3 250
Insurance and rates	14 200	Loan (6 months)	8 000
Interest expense	9 800	Mortgage (5 years)	120 000
Internet expense	22 700	Motel room sales	300 000
Inventory – breakfast supplies	3 200		
Inventory – motel supplies	36 500		
Land and buildings	458 000		
Laundry equipment	50 000		
Motel electricity	14 800		
Motel maintenance	17 300		
Office expenses	7 700		
Receptionist wages	15 200		
Shares in *Mercury Limited*	12 000		
	$930 750		$930 750

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Achievement Standard 91177

Interpret accounting information for entities that operate accounting subsystems

ACCOUNTING

2.4

Externally assessed 4 credits

Analysis and interpretation

Measures of profitability

Mark-up percentage

$$\frac{\text{Gross Profit}}{\text{Cost of Goods Sold}} \times 100$$

This figure shows how much (as a percentage) the business increases the cost price of its inventory to determine the final selling price. This figure should remain constant and only increase or decrease if there is a conscious management decision to alter it. If this figure decreases unexpectedly, reasons for change could include inventory loss, inventory damage, inventory theft or other pressures on the cost of goods sold, such as a change in the sales mix of price obtained from suppliers. Ideal percentage depends on type of goods sold.

Gross profit percentage

$$\frac{\text{Gross Profit}}{\text{(Net) Sales}} \times 100$$

This figure shows the percentage of sales dollars that convert directly to gross profit. This figure will deteriorate when cost of goods sold increases, sales decrease (with a less than proportional drop in cost of goods sold and gross profit) and as a result of the reasons stated above for mark-up percentage. An acceptable level for this measure is often thought to be 40% or greater, depending on the nature of the enterprise. To improve: increase mark-up %.

Expenses percentage

$$\frac{\text{Expense Type}}{\text{(Net) Sales}} \times 100$$

This figure shows the percentage of sales dollars that have been used by a particular expense being calculated. These figures should be kept at an absolute minimum, and will only deteriorate when expenses increase with a less than proportional increase in net sales (or if expenses have decreased). Common examples of expense percentages include the following.

1. Distribution costs percentage

$$\frac{\text{Distribution Costs}}{\text{Sales}} \times \frac{100}{1}$$

This analysis measure shows the percentage of sales spent on distribution costs. For example, a distribution cost percentage of 7% means that out of every dollar of sales made, the business spends seven cents on distribution costs. An increase in the percentage should lead to an increase in sales, since distribution costs include expenditure on items such as advertising, sales salaries, etc., which generate sales for the business. To improve: decrease spending on a specific distribution expense and explain how.

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2. Administration expense percentage

$$\frac{\text{Administration Expenses}}{\text{Sales}} \times \frac{100}{1}$$

This analysis measure shows the percentage of every dollar of sales spent on the day-to-day operating expenses of the business, e.g. rent, rates, electricity, etc. This percentage should be compared with the equivalent percentages in previous years and with those of similar businesses. A business should find ways to decrease this percentage without sales decreasing. An example of how to decrease this percentage would be to negotiate a cheaper rate with a supplier or to change a supplier (for example, electricity supplier or telephone and internet provider).

3. Finance costs percentage

$$\frac{\text{Finance Costs}}{\text{Sales}} \times \frac{100}{1}$$

Finance costs are the interest paid on loans, overdrafts and mortgages. This analysis measure shows how much of each dollar of sales is spent on interest. A business with a lot of debt will have high finance costs. However, the finance cost percentage might not increase if the business has borrowed money – for example, to buy more assets for the business which in turn are used to generate more sales. Ways to reduce finance costs include repaying debt, or switching from one lender to another that charges lower interest rates.

2.4

Net profit percentage (or Profit for the Year percentage)

$$\frac{\text{Net Profit}}{\text{(Net) Sales}} \times 100$$

This figure represents the proportion of net sales that converts directly into net profit. The net profit percentage is heavily influenced by gross profit changes, such that should the gross profit percentage fall, then the net profit percentage will usually fall as well. Also the level of expenses directly affects this profit percentage.

To identify if this percentage is at an acceptable level, decision makers should compare this figure with similar investment types and previous years' percentages. If net profit percentage is higher, then it is acceptable.

Return on average equity percentage

$$\frac{\text{Net Profit}}{\text{Average Equity}} \times 100$$

This figure illustrates the return the business is generating on the investment that the owner has made in the business. It is a figure that should be compared with prevailing bank interest rates (and other relatively low-risk investments) and with the returns offered by alternative investment proposals and portfolios, to determine if the risk/return relationship is satisfactory and if the funds invested by the owner are producing a satisfactory return. To improve: increase profit by increasing mark-up % or decreasing expenses. Do not advise decreased equity.

Return on total assets percentage

$$\frac{\text{Net Profit + Interest Expenses}}{\text{Average Total Assets}} \times 100$$

This figure measures how well the assets of the business are being utilised to generate a return for the business. It should also be compared with figures from previous years to show a trend. This percentage is affected when the business purchases new property, plant and equipment, usually decreasing the return in the first year, but in the long term the purchase should benefit the business. To improve: increase profit as described earlier, or sell off inefficient/unused PPE assets.

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Questions: Analysis and interpretation

You will be supplied with a formula resource containing the formulae to calculate the analysis measures. In the following questions, please use the formulae on pages 79–82.

Question One

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Part A

Refer to the following **Resource** to answer a. and b.

Resource

GoSki is a sole proprietor ski shop owned by Ray. *GoSki* is located in Wanaka, a popular winter ski destination. *GoSki* sells skis and related ski gear, including clothing and accessories. *GoSki* naturally makes more sales during the winter months than in the summer months. Two major advertising campaigns are undertaken using social media and local papers in autumn (April) and midwinter (July).

A ski gear clearance sale occurs in October. During summer, the shop sells tramping and mountain biking gear for summer visitors to the surrounding mountains and lakes.

Ray's accountant prepared a table of comparative figures extracted from the Income Statement for each half of the financial year ended 31 March 2018.

Notes:

- The first half of the year is from 1 April 2017 to 30 September 2017.
- The second half of the year is from 1 October 2017 to 31 March 2018.

GoSki **Half year Income Statement (extract)**		
Item	**1st half year**	**2nd half year**
Sales	250 000	200 000
Gross profit	162 500	120 000
Distribution costs	75 000	55 000
Half year profit	48 000	27 000

a. i. Calculate the mark-up percentage for *GoSki* for the second half of the year. Round your answer to the nearest whole percentage if necessary.

GoSki **analysis measure**		
	1st half year	**2nd half year**
Mark-up percentage	186%	____________%

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ii. Justify why the mark-up percentage is different in the first half of the year from the mark-up percentage in the second half of the year. In your answer, explain:
- the meaning of the mark-up percentage in the first half of the year
- the impact of the clearance sale on the mark-up percentage in the second half of the year
- how the seasonal nature of *GoSki*'s business results in different mark-up percentages in each half of the year.

Ray wants to take advantage of the growing numbers of trampers and cyclists using the walking and cycle trails around Wanaka in summer. He is considering changing the name of *GoSki* to *GoOutdoors*.

***GoSki* analysis measures**		
	1st half year	**2nd half year**
Percentage of total sales	56%	44%
Distribution cost percentage	30%	27.5%

b. Justify why changing the name of *GoSki* to *GoOutdoors* would increase sales without increasing the distribution cost percentage in the second half of the year.

In your answer, explain why a name change would:
- increase sales in the second half of the year
- not increase the distribution cost percentage in the second half of the year.

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Answers and explanations

Achievement Standard 91174 (Accounting 2.1): Demonstrate understanding of accounting concepts for an entity that operates accounting subsystems

2.1 Conceptual basis of accounting

p. 8

Question One

Part A

a. The purpose of the Statement of Accounting Policies is to inform users of the concepts and valuations used in the preparation of the financial statements for *Awa Motel*. It outlines the guidelines and any changes that might have occurred that impact on comparability. The Statement of Accounting Policies improves understandability as it provides information that is clearly set out and makes it easier for the users to make decisions. In this case, Max can see that the values used for the assets of *Awa Motel* is the Historical Cost as stated in the investment policy; however the current fair value for the shares is also stated in the Investment note – stating that in the Statement of Financial Position the shares in *Mercury Limited* are stated at cost, whereas in the note the current fair value is provided. The combination of these allows users to make more informed decisions.

(**A** = purpose of Statement of Accounting Policies and description understandability for *Awa Motel,* **M** = in addition to Achieved, explaining how the Investment note improves understandability for the users making decisions)

b. The shares in *Mercury Limited* are reported at their historical cost of $12 000 in the body of the Statement of Financial Position as this is the original purchase cost to *Awa Motel* when the shares were purchased. The shares meet the criteria of an asset because *Awa Motel* has control over this investment asset as Max can keep them or sell them for cash at any time and it is only *Awa Motel* that will benefit from this investment by receiving dividends or selling in the future. For information to be relevant for decision making, it should provide the predictive value of confirmed past events. In this case the current market value of $15 840 is more relevant to Max than the $12 000 historical cost in planning for his upgrade. This is because, although the historical cost confirms the amount paid for the shares was $12 000, it is more useful for Max to know what he can sell them for now as this is the cash he will use to help fund his bathroom upgrade. Therefore, the current market fair value of $15 840 is predicting the amount of cash he is likely to receive from the selling of the shares in *Mercury Limited* and whether he can afford the upgrade.

(**A** = definition of historical cost of shares $12 000 and definition of relevance $15 840 linked to *Awa Motel*, **M** = in addition to Achieved, explaining how the shares meet the asset criteria of resource controlled by *Awa Motel*, **E** = in addition to Merit, justifies why and how the current market value is more useful in respect of *Awa Motel's* decision to upgrade the bathrooms due to the predictive value of money received for selling the shares)

Part B

a. The accounting entity concept states that personal financial affairs of Max, the owner of *Awa Motel*, must be kept separate and distinct from the finances of the motel business. For this reason, when Max decides to give his friend Pam free accommodation, this is a personal transaction, not a business one. Even though Pam is not the owner, it is Max who has arranged the free accommodation and is preventing someone else from hiring the room and the cost of providing the free accommodation should be reported as drawings. The cleaning and breakfast costs would not have been incurred if Pam hadn't stayed, and therefore they should be accounted for. A business expense must not be a 'distribution to the owner'. Therefore, the cleaning and breakfast costs involved in this stay should not be a business expense, but recorded as drawings in the Statement of Financial Position of *Awa Motel*.

(**A** = explains the definition of accounting entity linked to the personal friend and costs, **M** = in addition to Achievement, explains with examples, **E** = justifies the reporting as drawings as a personal expense and that it doesn't meet the definition of an expense as it is a distribution to the owner)

b. The purpose of calculating the profit from the breakfasts separately from that of the motel accommodation is important in determining whether or not *Awa Motel* is making a profit or loss from this service. It will also give a more accurate account of the profit from the rooms. The qualitative concept of comparability requires information to be prepared in a consistent manner so the trends can be analysed and similarities and differences established. Being able to compare the profits from breakfast this year against those of previous years will allow Max to see whether the breakfasts are now more profitable, or less profitable. Even if sales have fallen, profit can still be reasonable (especially profit percentage). The cost of the free breakfast for Pam being reported as drawings is important as it wasn't a cost for the motel, but for Max personally.

If Pam's free breakfast expenses had been charged to the business expenses and no sales recorded, there would be an increase in expense and no income, reducing profit. This would reduce comparability and would have an impact on decision making. By having these costs recorded as drawings, the expenses and profit from the breakfast is comparable against previous years as they have been treated. This means the profit from breakfast is comparable and can help Max decide if he should keep supplying breakfasts or not.

(**A** = explains the purpose of keeping breakfast and room sales separate or defines comparability, **M** = explains comparability definition with reference to breakfast sales and profit for *Awa Motel*, **E** = justifies comparability definition with reference to breakfast sales and profit for *Awa Motel* and explains why the recording of Pam's breakfast costs as drawings enhances comparability)

Part C

a. The motel room sales received in advance, $25 000 excluding GST, should be reported as a current liability income in advance in the Statement of Financial Position of *Awa Motel* as at 31 March 2018. It meets the characteristic of present obligation as *Awa Motel* is presently obliged on balance day to provide the service of motel room accommodation to

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those people in the future, or to refund the cash paid if the booking is cancelled. It is probable that *Awa Motel* will have an outflow of resources embodying economic benefit in the next year as there is a greater than 50% chance that it will need to decrease the asset bank when it refunds the money paid if the booking is cancelled, or it needs to provide the room paid for and pay the costs incurred in providing the rooms. It is unlikely to double-book and not supply the room as that will ruin its reputation and result in a decrease in future sales. The Income in Advance is a current liability because the obligation will be required to be met in the next financial year / 12 months as guests can only book one year in advance.

(**A** = explains why income in advance is a current liability (next 12 months) and how it is a present obligation for *Awa Motel*, **M** = in addition to Achieved, explains the probable recognition criteria for *Awa Motel*, **E** = justifies the reporting of income in advance by fully detailing how it meets the recognition criteria and definition linking to the money and service to be provided / refunded by *Awa Motel)*

b. The write-down of breakfast supplies inventory meets the definition of an expense because it decreases the economics benefits in the form of depleting the inventory asset from $3 200 to $2 700 as the $500 inventory is now worthless. The money has already been spent to pay for the cereal, but it can no longer be sold as it is past its use-by date. This $500 increases expenses (Cost of sales – breakfasts) and decreases profit which decreases the equity of *Awa Motel*. The write-down is not drawings / used by Max the owner. The $500 can be measured reliably because the cereal that has expired is clearly identifiable and there will be invoices/receipts stating how much *Awa Motel* paid for these items and therefore how much the inventory has decreased. Because the cereal is being thrown out and unsaleable the need to write off the full cost is justified.

(**A** = explanation of write-down being an expense by decreasing inventory and decreasing equity for *Awa Motel* and drawings, **M** = explains in detail, with examples / reference to cereal, the write-down of inventory increasing expenses by depleting the inventory asset, and how the $500 can be measured reliably by *Awa Motel* (invoices for the cereal), **E** = in addition to Merit, discussion re expired inventory identifiable, having no resale value, decreasing inventory and increasing Cost of Sales Breakfasts because that was the cost of that inventory being thrown out by *Awa Motel*)

Question Two

Part A

a. The purpose of *Native Taupo's* Income Statement is to report the business's incomes and expenses, broken into classifications of distribution, administration and finance cost, in order to calculate and report the profit or loss for the year ended 31 March 2016. The entity concept states that the financial affairs of Holly, the owner, must be kept separate and distinct from the financial affairs of *Native Taupo*. This means any money invested by Holly is reported as capital and any payments for personal expenses by the business are reported as drawings in the Statement of Financial Position. This means that only business incomes and expenses are reported in the Income Statement, therefore ensuring that the profit reported is strictly the business profit. This enables Holly to determine if *Native Taupo* is successful by having a profit, or is not successful if there is a loss for the year. If Holly's personal incomes or expenses were reported in *Native Taupo*'s Income Statement, the profit would be inaccurate, e.g. lower profit than actual if Holly's personal expenses were included.

(**A** = purpose of Income Statement and description of entity concept with answer linked to *Native Taupo*, **M** = in addition to achieved, explaining how the information in the Income Statement meets the entity concepts for *Native Taupo*, **E** = justifies why and how the Income Statement reports only business transactions and can measure success or not)

b. The loan is a liability for *Native Taupo* because it is a result of a past transaction when *Native Taupo* borrowed the money to purchase the quad bikes earlier this year. *Native Taupo* is currently obliged to repay the loan over the next five years. In the future, over the next five years, *Native Taupo* must sacrifice the asset bank in order to make the payments to pay off the loan. This loan is reported as a non-current liability because *Native Taupo* has five years to repay it, and any debt not being repaid in the next year / next 12 months is reported as non-current. This five-year loan illustrates the going concern concept as it indicates that *Native Taupo* does not intend to liquidate but intends to continue to operate / sell herbs and bike tours to be able to repay the loan into the foreseeable future, for at least the next five years, or *Native Taupo* wouldn't have borrowed the money for so long and to expand the business.

(**A** = definition of liability linked to the loan and *Native Taupo*, and non-current liability taking more than one year to repay, **M** = in addition to achieved, explaining how the loan meets the definition, with reference to five years and decreasing bank, **E** = justifies why and how *Native Taupo* reports the loan as a non-current liability in accordance with the definition of liability, and is non-current and how this justifies going concern)

Part B

a. The accrual basis concept states that the transactions should be recognised when they occur. The effects of the transactions should be reported in the financial statements of the period to which they relate. The $600 advertising which has been paid in advance will be deducted from the advertising expense amount in the Trial Balance and Advertising will be reported at $2 300 in the Income Statement ended 31 March 2017. This is because even though *Native Taupo* has paid the money for the advertising this year, the business is yet to use the advertising and will report it as an expense in next year's Income Statement in the year the advertising is used. In the Statement of Financial Position, the $600 will be reported as Prepayments $600, a current asset, because the benefit of this asset will be received by *Native Taupo* in the next financial period when the advertising takes place, generating future economic benefit to *Native Taupo*.

(**A** = definition of accrual basis and an attempt to link the prepayment of $600 to one of the statements, **M** = explains the $600 prepayment with full definition and fully explained with reference to time period for one of the statements, **E** = justifies the reporting of the $600 prepayment in relation to accrual basis and fully explains the correct treatment and $ amounts in the statements)

b. Depreciation is the systematic allocation of the depreciable amount of the asset over its useful life. The units-of-use method to calculate depreciation on the quad bikes is based on how many kilometres the bikes have been driven. The more the bikes are used, the greater the depreciation expense for the year will be. This is the best method for the bikes because their loss in future economic benefit is directly related to how much they have been used/driven, and is not a fixed amount every year as straight line would be.

Relevance states that information must influence decisions by either confirming past events or helping predict current or future events. The carrying amount of the quad bikes is an example of relevance as the carrying amount of $27 800 best reflects the future economic benefits that *Native Taupo* is likely to receive from the quad bikes in the future. The historical cost confirms the $35 000 spent to purchase the bikes in the past, whereas the carrying amount is more relevant for decision making as it takes into consideration the usages of the bikes and their future benefit to *Native Taupo*.

(**A** = describes units-of-use method for depreciation for the bikes for *Native Taupo* and describes relevance in relation to carrying amount of the bikes, **M** = explains the units-of-use method being applied to the bikes for *Native Taupo* and relevance with a link/explanation to bikes carrying amount, **E** = justifies why the units-of-use method of depreciation is best for the quad bikes, and explains why and how the carrying amount meets future predictions criteria for relevance of the bikes linked to decisions for *Native Taupo*)

Part C

a. The herb sales on credit are an income for *Native Taupo* because they increase the assets accounts receivable when customers purchase the herbs on credit. The sales increase profit for the year by $70 000 which increases the equity of *Native Taupo*. The sales are not a contribution by Holly the owner but by paying customers. It is probable (more than 50% likelihood) that future economic benefit from the credit sales will flow to *Native Taupo* when the debtors/accounts receivable pay their accounts, which increases the bank

Answers

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