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.

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.

Constraints on relevant information

An important consideration involving the relevance of accounting information is **timeliness**. If information is out of date, it can be of little use. To get up-to-date information to decision makers may require reporting as yet incomplete information, thus damaging its reliability. However, if one were to wait for the 'complete package' of information, the data might have little use if it was then out of date.

Another constraint refers to **cost-benefit**. The benefits from reporting the information should outweigh the costs required to provide and use that information.

Financial elements

All accounts can be classified as one of five 'elements' – assets, liabilities, equity, income or expenses.

Assets

Assets are resources controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Assets	
Past	Transaction
Present	Control
Future	Economic benefit or service potential

Liabilities

A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Liabilities	
Past	Transaction
Present	Obligation
Future	Economic sacrifice

Equity – is the residual or 'left over' interest after total liabilities of an entity have been deducted from total assets.

Income – is increases in economic benefit in the form of inflows, enhancements of assets or decreases in liabilities that result in increases in equity. Income is not a contribution from the owner.

Expenses – are decreases in economic benefits in the form of outflows or depletions of assets, or increases in liabilities that result in decreases in equity. Expenses are not distributions (drawings) to owners.

Before any item can be reported in the financial statements, it must meet the following recognition criteria.

- It is **probable** that any future economic benefit associated with that item will flow *to* (in the case of assets and income) or *from* (for expenses and liabilities) the entity.
- The item's 'value' can be **measured with reliability** (that is, can be proven using a source document).

Measurement base

Historical cost

Assets and liabilities are recorded in the accounting records of the business at the price paid or received at the time the transaction took place. The recording of transactions (especially assets) at historical cost is easily understood and verifiable (the business has 'proof' of the value of the transaction in the form of source documents), and therefore it is reliable.

Assumptions

Going concern

An entity is assumed to be able to continue operating into the foreseeable future. Accountants prepare financial statements and provide information assuming the business will continue to trade (buy and sell goods/services) by classifying assets and liabilities as current or non-current. If the business owner (and/or accountant) is aware the business will not be continuing operation into the foreseeable future, this must be stated in the notes to the financial statements. This is the reason that the Statement of Financial Position is prepared using historical cost valuation, instead of the current value, or net realisable value.

Accrual basis

The effects of transactions and events on the entity's economic resources are reported in the period these effects occur, even if cash receipts and payments occur in a different period. In this way the transactions are recognised when they occur, and are reported in the financial statements of the period to which they relate.

> ***Example***
>
> You rent a shop weekly and pay the rent in advance. On balance day, 31 March, you pay rent of $700. That rent is recorded as being paid on that date, since that is when the transaction occurred. However, the rent payment is for the following week – that is, the transaction relates to the next week, which falls in the next accounting period – so reporting the $700 rent in this year's financial statements would result in an incorrect profit figure. A balance-day adjustment is required to ensure that the payment of $700 made on 31 March is NOT included as rent for the year ending 31 March, and also to ensure that there is an asset called 'prepayment' on that date, which is recorded in the Statement of Financial Position. The rent is reported in next year's Income Statement.

Notions

Accounting entity

The business being studied is called the accounting entity. The notion of accounting entity means there needs to be a clear boundary separating the financial affairs of the entities from the financial affairs of other entities (particularly the owner of the business). This results in only assets, liabilities, incomes and expenses of the entity (i.e. not of the owner) being reported in the entity's financial statements.

> ***Example***
>
> If an owner uses the business bank account to pay for personal expenditure, then that expenditure should be recorded as drawings, which decrease the equity of the business. The amount should not be recorded as a business expense.

Period reporting

The financial life of a business is divided into periods of equal length for reporting purposes, e.g. to calculate profit. This allows a business to accurately compare results from one accounting period to the next. In New Zealand, it is a legal requirement of the Inland Revenue Department to have an accounting period of one year in length.

Monetary measurement

Transactions are recorded in terms of the relevant currency for the business. New Zealand businesses, therefore, record all transactions and report the accounts affected in New Zealand dollars.

Capital and revenue expenditure

Capital expenditure is any expenditure that results in the increase of non-current assets – including installation and transportation costs (or the reduction of non-current liabilities), which usually has an impact on the entity *beyond the current accounting period*. Typically, capital expenditure affects the Statement of Financial Position.

> **Example**
>
> *The purchase by an accounting entity of a salesperson's motor vehicle* – results in the increase of the Non-current assets section and the reduction of Bank (or increase in liabilities); this transaction only affects accounts in the Statement of Financial Position, and the vehicle will benefit the entity beyond the accounting period.

Revenue expenditure is any expenditure that results in an increase in expenses and is likely to affect the business for the current accounting period. Such transactions affect the Income Statement, and are often recurring in nature.

> **Example**
>
> *Payment of current telephone account* – transaction affects only the current period and increases expenses (e.g. 'Telephone and Tolls'), therefore resulting in a decreasing profit for the current period.

Purposes and limitations of financial statements

The Statement of Financial Position

The terms 'Statement of Financial Position' and 'Balance Sheet' refer to the same accounting document. 'Statement of Financial Position' only is used in this Workbook.

Purpose of the Statement of Financial Position

This statement provides information about the financial position of the entity. It provides details of the assets, liabilities and equity of the business at a point in time, usually balance date. It can be used to determine the liquidity and financial structure of the business and can be used by the owner to determine the return on his/her investment in the business.

Limitations of the Statement of Financial Position

- The Statement of Financial Position of a business does not give the current market value of the business, since historical cost has been used to show the value of assets.
- It contains amounts which are estimates only; namely accumulated depreciation and allowance for doubtful debts. Therefore, the total assets value may be inaccurate.
- It shows only financial information and excludes non-financial information such as number of loyal customers; reliability of staff; advantages/disadvantages of location, etc.

The Income Statement

Purpose of the Income Statement

This statement provides information about the financial performance of the entity. It gives details of the income and expenses of the business and the profit or loss for the year. It makes it possible to determine the profitability of the business.

Limitations of the Income Statement

- It contains amounts which are estimates only; for example, depreciation expense and doubtful debts. For this reason, the profit/loss figure might be inaccurate.
- It shows only financial information and excludes non-financial information, such as number of loyal customers; reliability of staff; advantages/disadvantages of location, etc.

The Cash Flow Statement

Purpose of the Cash Flow Statement

This statement provides information about from where cash has been received, and to where cash has been paid. It also gives the increase or decrease in cash held during the accounting period and the opening and closing bank balances.

Limitations of the Cash Flow Statement

- It doesn't show non-financial information, such as number of loyal customers; reliability of staff; advantages/disadvantages of location, etc.
- It doesn't give details about the financial performance of the business. A net cash surplus doesn't necessarily mean the business is profitable.

Depreciation

Property, plant and equipment assets are expected to be used by a business over a number of years, or expected to produce a certain number of units or product.

This period of time is defined as the useful life, which is:

- the period over which an asset is expected to be available for use by an entity
- the number of production or similar units expected to be obtained from the asset by an entity.

It is usually expected that, at the end of its useful life, an asset will have a residual value, which is the expected value of the asset at that time. The residual value is estimated by calculating how much the business would get today if it had to sell the asset which was of the age and in the condition expected at the end of its useful life.

It is normally accepted that the residual value will be much less than the cost price of an asset – this is caused by age, obsolescence, use, or passage of time.

Depreciation is 'the systematic allocation of the depreciable amount of an asset over its useful life'.

	Example
The difference between the residual value and the cost price is called the **depreciable amount**.	A shop has a computer system which it bought in 2009 for $3 000. It is expected the computer will have a useful life of five years. If the shop were to sell a five-year-old computer system today, it estimates it would get only $500 for it. The depreciable amount is therefore $2 500 ($3 000 – $500 = $2 500).
The depreciable amount of an asset is used to calculate the depreciation expense.	The computer system will last for five years. The shop should therefore spread that $2 500 over five years. Therefore the annual **depreciation expense** on that computer system is $500.
Accumulated depreciation is the total amount of depreciation that has been allocated to that asset.	If the shop depreciates the computer at $500 per year, the accumulated depreciation after 3 years is $1 500.

Carrying amount is the cost price of an asset minus the accumulated depreciation.

Depreciation is recorded as an expense, because:

- it decreases an asset – the future economic benefit an asset provides decreases due to use during the period
- it results in profit for the business decreasing, which will decrease the equity of the business
- it is not drawings by the owner.

Depreciation method	Formula to use	When appropriate
Straight line	(Cost price – Residual Value) × Depreciation rate (%) or $\frac{\text{Cost price – Residual value}}{\text{Estimated useful life}}$	When the consumption/loss of service potential or future economic benefit of that asset is evenly distributed throughout its life; e.g. buildings or furniture, tools.
Diminishing value	(Carrying amount) × Depreciation rate (%)	When the consumption/loss of service potential or future economic benefit of that asset is likely to be greatest early on in its life; e.g. computer, motor vehicle.
Units of use	$\frac{\text{Units used (current year)}}{\text{Estimated total units}}$ × (Cost price – Residual value) or Depreciation rate (per unit) × Units used this period	When the consumption/loss of service potential or future economic benefit of that asset is caused by usage, or production from that asset, and accurate data are kept on units used; e.g. machinery (hours used), motor vehicles (km travelled).

Financial and non-financial information

When making decisions, users often use a variety of information:

- **financial information** – information with a monetary value, e.g. price, interest rate
- **non-financial information** – information that does not have a definitive money value, but that will affect the business's finances in the future, e.g. age of assets, location, customer base.

2.1

Questions: Conceptual basis of accounting

Question One

Part A

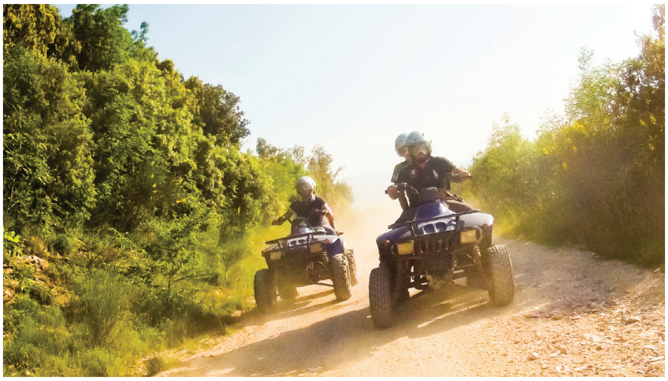
Year 2017
Ans. p. 117

Holly is the owner of *Native Taupo*. The business grows wild New Zealand herbs organically on her property in Taupo. She sells these herbs to local restaurants who use them in unique New Zealand meals for tourists.

a. Justify the importance of the **entity** concept in the preparation of *Native Taupo*'s Income Statement. In your answer:

- describe the **purpose** of *Native Taupo*'s Income Statement for the year ended 31 March 2016
- explain how the **entity** concept will be applied in the preparation of *Native Taupo*'s Income Statement for the year ended 31 March 2016
- explain how the use of the **entity** concept in *Native Taupo*'s Income Statement will make it easier for Holly to determine how successful the business has been in earning profit.

On 1 April 2016 Holly expanded the business by offering quad bike tours through parts of her property. To finance the purchase of the quad bikes, *Native Taupo* took out a five-year business loan.



b. Justify why *Native Taupo* reports the loan as a non-current liability in the Statement of Financial Position. In your answer, explain:

- using the **definition** of a **liability**, why the loan is reported as a liability
- why the loan is reported as **non-current**
- how reporting the loan as a non-current liability demonstrates the **going concern** concept.

Part B

Native Taupo **Trial Balance (extract) as at 31 March 2017**			
	$		$
Advertising	2 900		

Additional information:

- $600 of advertising, excluding GST, has been paid in advance by *Native Taupo*.

Use the trial balance extract and additional information above to answer **a.**

a. Using the **accrual basis**, justify **how** and **why** the $600 of advertising, excluding GST, paid in advance, was reported in both the Income Statement and Statement of Financial Position for *Native Taupo* for the year ended 31 March 2017.

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 *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 account, and the customers will want to pay, otherwise they will lose the ability to buy on credit in the future / it's a legal oblilgation / to keep a good credit rating.

(**A** = describes the credit sales of herbs as meeting the characteristics of income in context for *Native Taupo*, **M** = explains in detail how the credit sales of herbs meet the characteristics of income and some description of recognition criteria for income, **E** = justifies the reporting of the credit sales for herbs as income in this year's Income Statement in accordance with the income definition and recognition criteria)

b. Information is material if its omission or mis-statement will influence users' decisions. Materiality concept states that information that will influence decisions must be disclosed separately, whether by the nature of that account or the value of the item. Reporting the herb sales and quad bike tour revenue separately for *Native Taupo* is important for Holly as she can see the trends in both incomes as they are both material by nature, and this can help her decide what to focus on / promote in the future. For example, Holly can see that herb sales increased from $60 000 to $70 000 in the last year, and that the quad bikes generated $12 500 income and this is a material amount ($12 500) for a new income. This justifies that the quad bikes were a good investment and if this information wasn't disclosed separately Holly would not know this. This might help her decide to purchase more bikes, or purchase more herbs for resale in the future.

(**A** = describes materiality in context for *Native Taupo* and in relation to the separate reporting of the herb sales and the bike tours and attempts to link to a decision, **M** = explains in detail materiality in context for *Native Taupo* and in relation to the separate reporting of the herb sales and the bike tours and explains relevant decision, **E** = justifies materiality in context for *Native Taupo* by explaining the separate reporting of the herb sales and the bike tours using figures, and integrates a relevant decision using this information)

Question Two

Part A

a. The purpose of a Cash Flow Statement is to report the cash received and cash paid and the resulting increase or decrease in cash for a period of time, in this case showing that *Beachsplash* has increasing receipts and increasing cash surplus (from $8 000 to $25 000) for the past two years. The Cash Flow Statement is prepared under the assumption of monetary measurement in that all the figures in the statement are in New Zealand dollar terms. For example, the total payments are NZ$145 000 even if *Beachsplash* had to import some of its paddle boards.

The information provided in the Cash Flow Statement summary supports the decision making of *Torpedo7* because two years' information has been provided, allowing *Torpedo7* to see trends and to find similarities and differences between the two years. Seeing that the total receipts have increased greatly, from $145 000 to $170 000 in 2015 and there is an improving cash position over the two years and that there was a surplus of cash of $25 000 this year, helps *Torpedo7* decide to sell the paddle boards on credit, as *Beachsplash* has sufficient cash to repay them.

(**A** = purpose of cash flow and description of comparability and answer linked to *Beachsplash*, **M** = in addition to Achieved, explaining *how Torpedo7* will use the comparative information from the Cash Flow Statement, **E** = justifies *Torpedo7* using the cash-flow information to make its decision, explaining *why* and how *Torpedo7* uses the cash-flow information, with reference to features of comparability)

b. The paddle boards are an asset for *Beachsplash* because *Beachsplash* purchased the paddle boards on credit in the past from *Torpedo7*. *Beachsplash* controls the use of the paddle boards and has exclusive rights to them by deciding who to hire them to and by keeping them locked in storage while they are not being used. Customers will pay to hire the paddleboards for use in the surf, which will generate economic benefit in the future, which increases bank and hire fees received. It is probable (a more than 50% likelihood), that customers will pay to hire the paddle boards due to the boards' popularity, and the $15 500 cost of the paddle boards can be measured reliably because the amount is verified on the invoice from *Torpedo7*. *Beachsplash* will report the paddle boards as a non-current asset because *Beachsplash* will keep the boards to generate income beyond the current accounting period, continuing to hire to customers for several years.

(**A** = gives definition of asset linked to paddle boards and *Beachsplash*, and non-current asset keep beyond the current year, **M** = in addition to Achieved, explains *how* the paddle boards meet the definition, and some recognition criteria, **E** = justifies the reporting of the paddle boards as a non-current asset, explaining *why* and how *Beachsplash* reports the paddle boards as a non-current asset in accordance with the definition of asset and the recognition criteria)

Part B

a. Depreciation is the systematic allocation of the depreciable amount of the asset over its useful life. Because the paddle boards and billboards have different uses, their methods of depreciation should be different. Straight-line depreciation recognises that the loss in future economic benefit is consistent over the asset's life and this is why the straight-line method is best for the billboard. The loss in economic benefit of the billboard is consistent; e.g. $500 each year, or 5% p.a. because the billboard is fixed and its use does not change. The units-of-use method is best used when the loss of future economic benefit changes in direct relationship to how much the asset is used and the amount of depreciation varies depending on the usage. Because the loss in future economic benefit of the paddle boards is in direct relation to how much they are used (e.g. the more they are hired out, the greater the wear and tear and their loss in value), this method best reports their depreciation.

(**A** = definition of depreciation or an explanation of one of the methods for *Beachsplash* and the paddle boards or billboard, **M** = both methods of depreciation explained for *Beachsplash* and linked to the assets, **E** = justifies depreciation methods being different for the billboard and the paddle boards, because of usage and loss of future economic benefit for *Beachsplash*)

b. The footpath sign will be reported in accordance with historical cost, which requires *Beachsplash* to report the advertising expense at its original acquisition cost, which is $250 for the sign. Materiality requires that all information that is likely to influence the decisions of users be disclosed separately. An item can be material by value/amount or by nature. In this case the footpath sign is not a material item by nature, and the amount of $250 is immaterial in size, especially in relation to the $8 000 billboard (only 3%); therefore writing the street sign off as an expense, as opposed to as a non-current asset, will not influence the decisions of users of the financial statements, and the small amount is not going to misstate the profit, whereas the $8 000 would do so.

(**A** = defines historical cost in relation to the street sign and $250/*Beachsplash* and discusses an aspect of materiality, **M** = explains historical cost and materiality in relation to the street sign for *Beachsplash*, **E** = justifies the reporting of the street sign in accordance with materiality by discussing its value in relation to that of the billboard, and decisions)

Part C

a. The $500 is included as income in *Beachsplash*'s Income Statement as part of the paddle board hire and lesson income because it meets the characteristics of income. The $500 lesson fees have increased the asset 'accounts receivable' because the invoice has been issued for the lessons and hire earned this year. The hire fees increase *Beachsplash*'s profit for this year, which increases equity, and they are not a contribution by Wiremu the owner, but come from the local school.

Faithful representation requires *Beachsplash*'s financial statements to be complete, free from error and free from bias. The $500 invoice meets these criteria; if it was not included, the income and profit for the period would be incomplete and the hire fees would not fully represent the income for the year ended 31 March 2016. The $500 is free from bias because the school has not disputed the invoice, and it is accurate.

(**A** = describes how the $500 hire fees meet the characteristics of income in context for *Beachsplash*, **M** = explains in detail how the $500 meets the characteristics of income and gives some description of faithful representation with examples, **E** = justifies the reporting of the $500 paddle hire and lesson income in this year's Income Statement in accordance with the definition of income and the characteristic of faithful representation)