

Module 5: Introduction to Small Business Accounting

Assessment 3: Financial Practices and Statements

<h3>Assessment Answers</h3>

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Part A: Accounting Concepts and Financial Practices

Answer each of the 15 questions below in the spaces provided. Note that you **MUST** attempt to answer each question.

1. What are two actions that Ngahuia can take to minimise the fee for her Accountant?

There are a variety of ways that tauira could correctly answer this question. For example:

(1) File all payments in monthly sections

(2) Complete a bank reconciliation and check that supporting documentation for each transaction is available.

2. What is the main reason why Ngahuia must keep receipts?

To prove the value of the payments she has made for GST and income tax purposes.

3. What is the name of the concept where Ngahuia ensured her personal finances were separate from Kakahu Limited?

Accounting Entity

4. If Ngahuia does not do a bank reconciliation on a regular basis, and usually has a number of unrepresented cheques, what is the main mistake she may make?

She may spend too much money from her bank account, not leaving enough money to cover the cheques that have not yet been presented. I.e. the cheques may 'bounce'.

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5. How often should Ngahuia complete bank reconciliations?

Monthly

6. What will the income tax rate be for Kakahu Ltd during the 2013/14 financial year?

28%

(tauirā do not need to expand on this by saying its 28% because it is a company – as long as they get the tax rate correct they should get this question right).

7. What financial statement should Ngahuia use to work out whether Kakahu Ltd has made a profit?

Statement of Financial Performance

8. Ngahuia could not classify the purchase of her work van as an expense. What is the term used to describe how the cost of this work van will be spread over its useful lifetime?

Depreciation

9. "Profit is not cash or money in the bank".
Explain why this statement is true. You must refer to the Accrual Basis for accounting in your response and give one example of why profit is not cash or money in the bank.

Tauira could answer this in a variety of ways. One example is:

Profit is calculated using the Accrual Basis of accounting. That is, it is calculated as income accrued for the period minus expenses accrued for the period.

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Income and expenses accrued for a period do not necessarily match income and expenses received / paid for the period. For example, some customers may not pay their account until the following month. Therefore, although the sale is recorded in one period, the cash won't be received until the following period. The amount of profit the business earns will include this sale, yet this money will not be in the bank until the following period.

Tauira could also refer to non-cash expenses such as depreciation, etc. or refer to cash items that aren't reflected in the statement of financial performance (such as GST, capital purchases, etc).

10. Who sets depreciation rates, and in what document can these be accessed?

The IRD sets the depreciation rates. These can be found in the document 'General Depreciation Rates (IR265)'

11. The Fixed Asset Register shows the net value of an asset at Balance Date (i.e. the closing balance of the Fixed Asset Register). Give one other example of information that is included in the Fixed Asset Register.

Answers could include:

- * the date on which the asset was purchased*
- * a description of the asset*
- * the depreciation rate applied*
- * the depreciation method used*
- * the historical cost / purchase price*
- * the net value of the asset as at the start of the period*
- * the amount of depreciation calculated each month*
- * the total amount of depreciation for the period / year*
- * total accumulated depreciation to date.*

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12. Assume Ngahuia pays rent of \$500 per month and that she paid the first 6 months rent of \$3000 on 1 April 2013. Six months later on 1 October 2013, she paid a lump sum of \$6000 for the next 12 months half way through the year. At the end of the year, Ngahuia's accountant will need to make a Journal entry to adjust for this rent paid in advance. Answer the questions below to explain how this \$9000 will be shown in the end of year financial statements (as at 31 March 2014).

How much of the \$9000 would be classified as an expense for the year?

\$6,000

In what financial statement would the expense be shown?

The Statement of Financial Performance

How would the remaining amount of the rent payment be classified?

As a prepaid expense (tauirā could state 'current asset').

In what financial statement would the remaining amount be shown?

The Statement of Financial Position

13. Explain, in your own words, what is meant by the accounting concept of 'Comparability'.

A possible answer:

For financial statements to be useful and understandable, they must be able to be compared to other reports. I.e. a business owner should be able to compare their financial statements from one year to the previous years to see if they have performed better or worse or to see if their financial position has improved. A business owner should also be able to compare their reports to those of other similar businesses to see how well their business is doing.

As long as tauira convey that they understand the essence of this concept (without copying word for word out of the module) they should be marked as 'achieved'.

14. In Accrual Basis accounting, when is income recorded for accounting purposes?
(Circle the correct answer)

a. When the service is ordered or requested.

b. When the service is performed and the invoice generated.

c. When the cheque for payment is received.

15. Why must the Statement of Financial Performance for Kakahu Limited be completed *before* the Statement of Financial Position?

Because the amount of Net Profit to be entered in the Equity section of the Statement of Financial Position (and the amount of the Tax Liability) is calculated from the Statement of Financial Performance.

To get this answer correct taurira do not have to mention both the net profit figure and the tax liability figure. For example an answer such as 'because the Statement of Financial Performance calculates the net profit figure' is acceptable.

Part B: The Trial Balance

Write your answers here:

A = \$132,000

B = \$1,200

C = \$752

D = \$3,636

E = \$145,636

Kakahu Limited

Trial Balance as at 31 March 2014

	Dr	Cr
Revenue		
Sales		132,000
Expenses		
Purchases	68,300	
Accountancy Fees	6,000	
Advertising	2,450	
Telephone	788	
Insurance	550	
Lease	6,000	
Wages	15,000	
Stationery	1,260	
Computer Expense	320	
Vehicle Expenses	2,500	
Electricity	1,200	
Assets		
Bank	17,366	
Accounts Receivable	752	
Motor Vehicle	5,460	
Office Equipment	17,690	
Liabilities		
Accounts Payable		3,636
Equity		
Opening Equity		10,000
Total	\$145,636	145,636

Part C: Financial Statements

Kakahu Limited Statement of Financial Performance for the Year Ended 31 March 2014			
	\$	\$	\$
<u>Income</u>			
Sales	132,000.00		
<i>less Cost of Goods Sold</i>			
Purchases	68,300.00		
Gross Profit		63,700.00	
<u>less Expenses</u>			
Accountancy Fees	6,000.00		
Advertising	2,450.00		
Telephone	788.00		
Insurance	550.00		
Lease	6,000.00		
Wages	15,000.00		
Stationery	1,260.00		
Computer Expenses	320.00		
Vehicle Expenses	2,500.00		
Electricity	1,200.00		
Total Expenses		<u>36,068.00</u>	
Net Profit			27,632.00
Income Tax			7,736.96
Net Profit After Tax			<u>19,895.04</u>

Statement of Financial Position Template

Kakahu Limited Statement of Financial Position as at 31 March 2014			
	\$	\$	\$
Assets			
<u>Current Assets</u>			
Bank	17,366.00		
Accounts Receivable	<u>752.00</u>		
<i>Total Current Assets</i>		18,118.00	
<u>Fixed Assets</u>			
Motor Vehicle	5,460.00		
Office Equipment	<u>17,690.00</u>		
<i>Total Fixed Assets</i>		<u>23,150.00</u>	
TOTAL ASSETS			<u>\$41,268.00</u>
Liabilities			
<u>Current Liabilities</u>			
Accounts Payable	3,636.00		
Income Tax Liability	<u>7,736.96</u>		
<i>Total Current Liabilities</i>		11,372.96	
Equity			
Opening Equity	10,000.00		
	<u>19,895.04</u>		
<i>Closing Equity</i>		<u>29,895.04</u>	
TOTAL LIABILITIES PLUS EQUITY			<u>\$41,268.00</u>