

FREE SAMPLE: THE FIRST QUESTION

Question One (11 marks)

(a) Wiremu's Services earned fees of \$20 000 for work completed for a client during the year. The client has not yet paid.

Justify why the fees earned should be reported as revenue (income) in the Income Statement. In your answer, explain:

- the three characteristics of the revenue definition
- the recognition criterion of faithful representation for this item.

[6 marks]

(b) Wiremu's Services uses simple headings such as Current assets and Current liabilities, and explains its calculations in the notes. A note explains the allowance for doubtful debts of \$2 000.

Discuss how this affects the owner's decision making. In your answer, explain:

- the qualitative characteristic of understandability
- one limitation of the way the information is reported.

[5 marks]

THE WORKED ANSWER TO THAT QUESTION

Question 1 (11 marks) [Financial elements and qualitative characteristics]

(a) Wiremu's Services earned fees of \$20 000 for work completed for a client during the year. The client has not yet paid. Justify why the fees earned should be reported as revenue (income) in the Income Statement. In your answer, explain: • the three characteristics of the revenue definition • the recognition criterion of faithful representation for this item.

(a) Answer: The fees earned should be reported as revenue (income): it increases profit and so increases equity; it increases assets or decreases liabilities; it is not capital contributed by the owner

- Evidence level: Excellence (applies all three characteristics to the case and links the recognition criterion to documented evidence).
- Achievement: Revenue (income) has three characteristics: it increases profit and so increases equity; it increases assets or decreases liabilities; and it is not capital contributed by the owner.
- Merit: Revenue (income) has three characteristics: it increases profit and so increases equity; it increases assets or decreases liabilities; and it is not capital contributed by the owner. For the fees earned: the fees increase profit, and so increase equity; the fees increase the asset accounts receivable; and the fees were earned by the business, not capital put in by the owner. So it is revenue in the Income Statement (invoice basis).
- Excellence: Revenue (income) has three characteristics: it increases profit and so increases equity; it increases assets or decreases liabilities; and it is not capital contributed by the owner. For the fees earned: the fees increase profit, and so increase equity; the fees increase the asset accounts receivable; and the fees were earned by the business, not capital put in by the owner. So it is revenue in the Income Statement (invoice basis). Faithful representation: the amount can be reported because there is documented evidence – the invoice sent to the client shows the fees of \$20 000 – so the figure is complete, neutral and free from material error. If the owner had put the money in as capital, it would increase equity but it would not be revenue and would not be reported in the Income Statement.

KEY TAKEAWAY

To justify an element, name its three characteristics, show each one in the scenario, then use documented evidence to show the amount is faithfully represented.

(b) Wiremu's Services uses simple headings such as Current assets and Current liabilities, and explains its calculations in the notes. A note explains the allowance for doubtful debts of \$2 000. Discuss how this affects the owner's decision making. In your answer, explain: • the qualitative characteristic of understandability • one limitation of the way the information is reported.

(b) Answer: Understandability: Understandability means information is classified, described and presented clearly and concisely so users with reasonable knowledge can understand it

- Evidence level: Excellence (defines the characteristic, applies it with figures, and links a limitation to decision making).
- Achievement: Understandability means information is classified, described and presented clearly and concisely so users with reasonable knowledge can understand it.
- Merit: Understandability means information is classified, described and presented clearly and concisely so users with reasonable knowledge can understand it. In this case, the headings and the note about the \$2 000 allowance help the owner to see what the figure is and how it was found.

- Excellence: Understandability means information is classified, described and presented clearly and concisely so users with reasonable knowledge can understand it. In this case, the headings and the note about the \$2 000 allowance help the owner to see what the figure is and how it was found. Limitation: a short, simple report may leave out detail that a more expert user would want. The owner must therefore weigh the benefit of the information against this limitation when making decisions.

KEY TAKEAWAY

Define the characteristic, use the figures from the case to show it, and finish with a limitation and what it means for the decision.

LOS: Financial elements and qualitative characteristics (91174)

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