

MERIT EXEMPLAR comments (to be inserted in a bubble next to the appropriate question)

Question Number	Comment
PART A	
(a)	No comment – straightforward.
(b)	A grade awarded as the candidate has correctly explained the advantage of limited liability
(c)	No comment – straightforward.
(d)	A name being “checked” by the registrar of companies is sufficient evidence to indicate that Mary has registered the name.
(e)	This question has only an E grade available so a candidate’s answer must be complete with no errors in wording and must be answered in context. By writing the last sentence “because of the separation between company and personal accounts” the candidate is making reference to the accounting entity concept. However this concept applies to both sole proprietor and company structures and is enough to undo the candidate’s correct answer.
(f) (i)	No comment – straightforward.
(f) (ii)	A grade awarded as candidate makes reference to cost vs. benefit with a reason explained.
PART B	
(a) (i)	A grade awarded. The answer refers to “sacrifice the economic benefit of money” to repay the loan which is sufficient evidence to indicate giving up money to repay the loan.
(a) (ii)	E grade awarded as the candidate has made a link from the loan source documents to “easily verify”, which is sufficient evidence to an aspect of reliability.
(b) (i)	D only as the candidate only refers to budgets helping predict what will happen in the future and has not given an example of what kind of information is predicted in the budget
(b) (ii)	E grade awarded as the candidate has given an example of how Mary may be bias when preparing her budget “may state her revenues higher”
(b) (iii)	A grade awarded as “future budgets to make them more accurate” is sufficient evidence for a reason why Mary compares budget with actual results.
(c)	A grade awarded as the candidate refers to ACC Fees Receivable. Note by stating “without a change in liabilities” is acceptable, but it is advised that a candidates makes no reference to liabilities as the context results in assets increasing. The E grade is not awarded as the candidate has not explained the inflow of future economic benefit.
(d)	A grade only as the how the wages owing will be reported is missing for the E grade i.e. added to the wages expense or as Accrued Expenses
(e)	D grade only as there is no link made to the Expense definition
(f)	No E grade awarded as the candidate has not recognised that the chairs do have future economic benefit or could be recorded as an asset
Overall Comment	This candidate has 14 grades awarded that only included 2E – hence the overall grade Achieved with Merit. This candidate lost an E grade in Question Part A (e) by writing an incorrect sentence at the end of the answer. It is advised that candidates do not need to “fill up” all lines provided in the question and must re-read / check their written answers.

You are advised to spend 40 minutes answering the questions in this booklet.

PART A

Mary Peters is a sole-proprietor physiotherapist, who has her main clinic in Thames. She employs two other physiotherapists, so she is able to run a twice-weekly clinic in Waihi.

Mary has decided to expand her business by turning it into a company and opening a new clinic in Whangamata. She has nearly half the finance she needs for the expansion, and the bank has agreed to lend her the rest, secured over her business assets.

Mary is married with two young children and is concerned that the family assets be protected from her business, should it experience financial difficulty.

- (a) State ONE **disadvantage** for Mary of turning her business into a company.

She will have to pay a registration fee and fill out paperwork. D

- (b) Explain the **main advantage** for Mary of turning her business into a company.

She will have limited liability. This means that Mary will not be personally liable for any of her company's debts, and her family assets will be safe from any debts incurred by the company. A

- (c) State ONE reason why Mary chose **not** to go into partnership with her employees.

Mary may not have wanted to share the profit she was making with other people. As she is

the sole owner of shares, she can just pay herself a dividend, and in a partnership she would have to share it. D

- (d) State ONE step Mary must take in the process of registering her company.

Mary must find a suitable name and get it checked by the registrar of companies. D

- (e) As a sole proprietor, Mary's wages were reported as drawings. As a company, Mary's wages are reported as an expense.

Fully explain the **different treatment** of Mary's wages in a sole proprietorship compared with a company.

In a sole proprietor, Mary's wages are treated as payment of her share of the profit, she can just decide how much to withdraw. In a company, her wages are an expense because they do not represent a share of profit (dividends), they are just her payment like any other employee as per contract. This is because of the separation between company and personal affairs.

- (f) Mary's business will be an exempt company for the purposes of the Financial Reporting Act.

- (i) State ONE requirement for a company to be classified as exempt.

Not a subsidiary of another company.

D

- (ii) Explain why exempt companies are **not required** to prepare financial statements in accordance with Financial Reporting Standards.

The extra costs involved in ensuring full compliance with all Financial Reporting Standards exceeds the benefit to users of the company. This is because the companies are small and have no major ties to other companies, so there is little interest in their reports.

A

PART B

Mary has decided to call her company *Dynamic Physio Ltd*, with herself and her husband as the sole shareholders and directors.

(a) Explain why the loan from the bank to finance the business expansion meets,

(i) the following **characteristic of a liability**:

"there must be adverse financial consequences for the entity, in that the entity must be obliged to sacrifice service potential or future economic benefits to one or more other entities" (ICANZ Statement of Concepts)

In the future Dynamic Physio Ltd will have to repay the bank loan. This means that Dynamic Physio will have to sacrifice the economic benefit of the money used to repay the loan to the bank. This means that the loan meets this characteristic. A

(ii) the following **recognition criterion of a liability**:

"the amount of the liability can be measured with reliability" (ICANZ Statement of Concepts)

We can measure the size of the bank loan to Dynamic Physio Ltd with 100% certainty as we have source documents from the bank stating how much the loan is for. We know exactly how much the loan is worth, and we can easily verify it, so the loan definitely meets this criteria. E

(b) Mary prepared a budget for the first six months of operation of the new Whangamata clinic to help her decide whether to expand her business.

(i) Explain how the information in Mary's budget meets the qualitative characteristic of relevance in terms of **predictive value**.

She can use her budget to predict what will happen in the future. This means she will be able to make decisions based on it, for the future of her business, so it has predictive value. D

- (ii) Explain why the information in Mary's budget may not be neutral in terms of the qualitative characteristic of reliability.

~~She~~ Mary may have portrayed her budget with a certain degree of bias. It may not be deliberate, but she may tend to be naturally optimistic and so state her revenue as higher than an independent source would suggest. Because Mary is so close to her business, we cannot rely on her being neutral.

- (iii) Explain how, after operating the Whangamata clinic for six months, Mary will make use of the **comparability** qualitative characteristic of the information contained in her budget.
- Mary will be able to look at her budget and then compare the values for it with the actual results for the period. This will allow her to adjust any future budgets to make them more accurate.

- (c) A significant number of Mary's patients are on ACC. This means that their treatment is partly paid for by ACC, the month following their appointment.

Fully explain why Mary treats the accounts receivable from ACC as **Fees Revenue** on the date of the patients' visits in terms of the following definition of revenue:

"revenues are inflows of future economic benefits in the form of increases in assets or reductions in liabilities of the entity, other than those relating to contributions by owners, that result in an increase in equity during the reporting period." (Adapted from ICANZ Statement of Concepts - definition of Revenues.)

Mary treats them like this because once she has seen a patient, ACC owes her money for payment of the treatment. This money owed by ACC will be of future economic benefit and will increase her assets of ACC Fees Receivable. Mary has not contributed any money, and the ACC fees increase equity as they increase an asset without a change in liabilities. On the whole, ~~fees revenue~~ accounts receivable from ACC is definitely a revenue source.

- (d) Fully explain how the reporting of wages owing to the physiotherapists on balance day illustrates the accrual basis.

Assessor
use only

This illustrates the accrual basis in Dynamic Physio because the physiotherapists have worked for May in this financial year, ~~the~~ but are owed more money than they have been paid. As the work to which those wages relates occurred in this current period, by the accrual basis concept it is reported in the current period. A

- (e) When Mary pays a dividend to the shareholders of Dynamic Physio Ltd this is reported in the Movements in Equity statement. Explain why a dividend is not an expense of Dynamic Physio Ltd.

A dividend is not an expense of Dynamic limited because it is a distribution to owners. Due to the company being a separate legal entity to the owners, we cannot just call dividends an expense, they are a change in the equity of a company that does not affect the profit. D

- (f) Dynamic Physio Ltd has furniture and equipment with a total cost of \$30 000. When Mary buys new chairs costing \$150 for her waiting room, she records this as an expense rather than an asset in the records of Dynamic Physio Ltd.

Fully explain why she is able to do this in terms of the concept of materiality.

It is not likely that the decisions made by anyone using the report will change based on the nature of Mary's purchase of chairs as it is just a routine use of money, or the amount of the purchase compared to the total of the equipment. A

As this item is not of such a nature or amount which affect the decision of users, ~~it~~ it doesn't need to be recorded separately according to materiality, it is immaterial.

60 7A 2E

(M)

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