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TOP SCHOLAR

NZQA

NEW ZEALAND QUALIFICATIONS AUTHORITY
MANA TOHU MĀTAURANGA O AOTEAROA

QUALIFY FOR THE FUTURE WORLD
KIA NOHO TAKATŪ KI TŌ ĀMUA AO!

Scholarship 2015
Accounting

2.00 p.m. Monday 23 November 2015
Time allowed: Three hours
Total marks: 40

ANSWER BOOKLET

Check that the National Student Number (NSN) on your admission slip is the same as the number at the top of this page.

Write your answers in this booklet.

Show ALL working. Start your answer to each question on a new page. Carefully number each question.

If you need more room for any answer, use the extra space provided at the back of this booklet.

Check that this booklet has pages 2–24 in the correct order and that none of these pages is blank.

YOU MUST HAND THIS BOOKLET TO THE SUPERVISOR AT THE END OF THE EXAMINATION.

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Q1. There has been serious concerns raised regarding natural capital being eroded at such fast pace. Natural capital are elements of nature that are of use to human beings including living and nonliving as well as renewable and non renewable resources. Fish stocks, minerals, bees, and ocean are few examples of natural capital. Accounting for natural capital focuses on the environmental aspect of a firm's sustainable management. Monetary values are given to stocks of natural ecosystems in consideration of a firm's usage of the resource as well as the scarcity of the resource. For example, puma publically shares its environmental profit and loss account relating to water consumption from production. According to WWF'S 2016 living planet report, we are said to be drawing down on 50% more natural capital a year than the earth can replenish. The uncompensated effects of production on environment include climate change, loss of biodiversity, extinction of plant species, and depletion of natural resources overall. If we continue operating business 'as usual', it is expected that by ~~2020~~ 2030, ~~2030~~ we will require the natural capital equivalent to 2 planets to sustain ourselves. Accounting for natural capital is an important issue that should be seriously concerned, as all too soon, businesses will face a stark choice: adapt or fail.

Accounting for natural capital will provide businesses with opportunities. These benefits include managing risks in supply chain, stable profits in the long run, sound cash position, and enhancement of brand

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reputation for sustainability. Alan McGill, a partner at pwc believes that accounting for natural capital will provide businesses with a new type of good growth for the future viability of the business. coca cola for example currently holds a strong focus on water stewardship, and are targeting to replenishing as much water it uses by ~~2030~~. 2020. puma is measuring greenhouse gas emissions, land usage, and waste. These businesses adapting to natural capital accounting are not only managing risks in supply chain, but are also providing their stakeholders with information they can use to determine the firm's ability to create value over time. More specifically, investors will be able to see whether a company is likely a going concern or not, which will be a very useful information in their decision making on investment. Employees could be assured of their long term employment in the business. The government can also determine whether the company is environmentally sustainable or not. In a modern society where consumers are becoming more environmentally focused; businesses adapting to natural capital accounting is likely to experience financial growth. Overall, accounting for natural capital will provide businesses with benefits.

There are also risks involved with natural capital accounting. For any information to be included in financial statements, they must meet the qualitative characteristics of relevance, reliability, and comparability.

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Information of natural capital could well be relevant as users of financial statements could be influenced to make more sustainable decisions - be it a decision to invest in the company or not by a investor, or the decision to subsidize the company or not by the government. For example, had NZ dairy farmers included the information of their usage of palm kernel oil in their financial statements, would our overseas trading partners have purchased a lower quantity of beef from NZ? However, the value of natural capital is very hard to measure as businesses do not actually purchase natural resources, in which there will be no source documents regarding its value. In addition, although puma and kingfisher plc have both incorporated natural capital accounting into their business practices, their approach to the concept is very different. For information of natural capital to be comparable - the method to account for it needs to be universal, and standardized. Furthermore, will users of financial statements be able to understand, and communicate the information of natural capital if they are accounted for in the statements? These altogether reach the conclusion of natural capital lacking some qualitative characteristics to be precisely, and accurately accounted for.

Accountants have a pivotal role in incorporating natural capital accounting into business models. They are to draw out the connection between

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natural capital, commercial opportunity as well as financial performance and risks. Accountants can approach the concept by raising natural capital as a strategic issue - collecting data, developing relevant skills to account for it, using natural capital in decision making, managing risks, and reporting. For example, the accountant for Kingfisher plc identified the risk of potential timber wood shortages, and thus the company made a decision to create more forests than it uses. By doing so, the accountant not only managed risk, but also identified ~~the~~ commercial opportunity, as sustainably managed wood will increase brand reputation of Kingfisher plc for sustainability. In addition, accountants have the role of influencing other national and international organizations to support the development of natural capital accounting. This is because for the information of natural capital to be comparable - the method to account for it needs to be universal and standardized. In one sentence, accountants have the role of leading their organizations towards the creation of value.

Natural capital are currently being eroded at such fast pace, thus the idea to account for it developed. All businesses participating in global economy will be shortly affected - if not already. They are not only to be negatively affected from the decelerating

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level of natural resources available for production, and thus operation - but also from the flow on effects or risks in supply chain, declining profits, cash flow problems, and brand image damages. Given the current rate of depletion of natural resources it will even lead to the issue of going concern or not. Accounting for natural capital will provide businesses, and their stakeholders with benefits. However there are also risks involved due to natural capital partially lacking qualitative characteristics of accounting. Accountants not only have the role of redefining corporate responsibility as to include natural capital accounting - they also have the role of promoting natural capital accounting at a global level. Altogether, accounting for natural capital is a serious current matter that should be considered.

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~~Q2. The first entry shows a journal entry of an expense An expense~~

~~Q2. The first entry shows a journal entry of an expense with debiting $500000 to remuneration in advance, and crediting $500000 to cash.~~

Q5. pumpkin patch limited (PPL) is a childrenswear retailer, with its target audience being middle income earning parents, and grand parents. It has built a reputation for selling premium childrenswear since being established in New Zealand in 1990. PPL shares have traded as high as $4.85 in February 2007 upon being introduced at $1.37 in June 2004 on NZX. However, PPL's financial performance has been fluctuating at a concerning level since 2010. Share prices have dropped tremendously, with current market price being $0.13. The root cause for such fluctuation appears to have been the use of outdated brick and mortar strategy, decrease in brand value, and inefficiency in PPL's supply chain. Bella Katz, Australian brand and marketing analyst has even suggested that "while parents' demands have changed, pumpkin patch designs did not." Numerous sources have commented on the complexity of PPL's supply chain thus its inefficiency with ANZ insights team being one of them. In spite of measures taken by the management such as appointing a new CEO, and

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implementing a 2 year project ; it is highly doubtful that PPL's share prices will become sound, and stable.

The 2014 trading year proved to be perhaps the peak year in the company's poor execution, with profitability, liquidity, market position, financial stability, and cash position all worsening. PPL recorded a net loss of $10.1M for the 2014 period. This was a significant fall by 298% from the previous years' profit of $5.1M. The fall was mainly caused by the 16.6% decrease in revenue in combined effect of recording $14.6M reorganisation costs. Attention should be drawn to the fact that Australian sales fell by 22.3%, given that Australia is a key market for PPL. Bella Katz has even stated "If PPL is going to survive, it needs to make Australia work." Peter Schuyt, the chairperson of PPL justified the reasons behind the company's appalling financial results to have been challenging retail conditions, unfavourable movement in the exchange rate, and inefficient supply chain management. PPL did encounter several supply chain issues, which reduced its ability to meet customer demand at key times of the year. In addition, production delays lead to PPL holding onto out of season stock, thus contributing to sales falling.

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~~Chatt~~ Retail conditions were also very challenging. However, the warehouse, and Hallenstein Glasson Holdings Limited both of which are retailers were able to record a net profit of $58m and $14M accordingly in the same year despite encountering same macroeconomic influences as PPL did. This implies that ~~measures taken to~~ the poor financial performance of PPL was not entirely because of macroeconomic influences, but partially because of the decrease in brand value. Furthermore, PPL has recently announced its earnings for 2016 to be even lower than in 2014. This is rather ironic given that by 2016; the two year project the management team implemented should be well underway. Sharon Zollner, ANZ senior economist also predicted the exchange rate to change in favour of PPL as in depreciate. Altogether, PPL's profitability is unlikely to improve in short or long run.

PPL's liquidity once again confirmed that PPL has had a challenging year in 2014. Current ratio was well above the benchmark - 3.04:1 due to current assets increasing from PPL holding onto greater inventory, whilst current liabilities decreasing from ANZ extending the maturity date of PPL's borrowings until ~~to~~ 2017. Liquid ratio was below the benchmark - 0.58:1

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Although PPL's sales are mostly cash based, the low liquid ratio is concerning given the strict banking covenants in place as well as PPL's current cash position. A positive cash flow from operating activities is crucial as it determines a company's ability to continue as a going concern. PPL on the contrary, recorded a net deficit of $8M from operating activities. It is doubtful whether PPL can continue as a going concern. PwC even included a 'emphasis of matter' paragraph in the 2014 auditors' report, outlining their concern of PPL's heavy reliance on bank funding to be highly risky. It remains uncertain whether PPL can meet the strict banking terms and continue as a going concern.

PPL's market position has also weakened, with recording a negative earnings per share of (6.0) cents. The warehouse on the other hand, was able to record a higher basic earnings per share of 18 cents. This clearly shows that PPL is particularly underperforming. Both PPL's dividend yield, and dividends per share were zero. This is because PPL has not issued any dividends since 2011. No final dividend was declared for 2014, as reduction of bank debt remains a key priority for PPL as said by Peter Schunt. PPL also recorded a

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negative price earnings ratio, which is invalid. on the contrary, PPL was able to record a relatively high price earnings ratio of 5.7 in 2013. This clearly shows that investors have lost confidence in PPL's growth potentials over time. Don Trow, an accounting professor at Victoria university suggested that "This is perhaps the market telling us this is the end for PPL." Bella Katz also agreed with this idea, stating that PPL does not understand its customers' requirements. Both statements appear to be true when comparing PPL to other retailers such as the warehouse and Hallenstein Glasson Holdings limited. Both of these companies performed above expectations despite encountering same challenging retail factors as PPL did.

Although Luke Burnt, who is highly respected in the retail sector, will now lead the management team; it is unlikely that PPL's financial performance will be turned around and thus its share prices become stable. Luke admitted to having no prior experience in turning a company around. Di Humphries - the past CEO, was also highly respected for her experience in retail. Yet, PPL heavily underperformed under her lead. Chelsea Leadbetter has also stated "No one has ever managed to turn PPL around nor improve its inventory management

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despite the frequent changes in the management team." Therefore, the trend in PPL's shares of declining by ~~6~~ 63% in the past 52 weeks is likely to continue. There is a high chance that ANZ will step in and take over PPL as ~~suggested~~ agreed by Mike Taylor, the founder of Pig Funds. It is unlikely that a third party will acquire the company given its high level of debt. Altogether, it can be viewed that ~~PPL~~ the measures taken by the management team to stabilise PPL's share prices have not been successful.

A8

Q3.

	COS	DC	AE	FC	Total
Auditors remuneration			19648		19648 ✓
Bad debts			13020		13020 ✓
Dep - fixtures, fittings		12100.	~~[illegible]~~		12100 ✓
Dep - manufacturing	28938.				28938 ✓
Directors' fees			39480		39480. ✓
Discount on sales		2900			2900 ✓
employment benefit	43740.	16225	10935		72900 ✓
Interest on loan				31160	31160.
loss on sale.	7640				7640. ✓
other expenses	8280 ~~3450~~	3450	2070	[illegible]	13800 ✓
Raw materials ...	205472				205472. ✓
Rent paid	21240.	8850	5310		35400 ✓
Δ in inventory	4120				4120 ✓
Donations.			2690		2690 ✓
	~~314600~~ ~~3149~~ 319430	~~42075~~ 45525	93153	~~344470~~ 31160	469268

poello Limited

Statement of comprehensive income (by function)

for the year ended 30 June 2015

	Note	NZ$
Revenue	1	527088
Less cost of sales		(319430)
Gross profit		207658
Add other income	2	78260
Total income		285918
Less expenses		
Administrative expenses		(93153)

	Note	NZ $
Distribution costs		(45525)
Operating profit before interest, and tax	3, 4	(147240
Less Finance cost	5	(31160)
Profit before taxation		116080
Income tax expense		(38290)
Profit for the year		~~77794~~ 77790
Add other comprehensive income		
Gain on revaluation of land		11800
Total other comprehensive income for the year		11800
Total comprehensive income for the year		~~[illegible]~~ 89590

Pello Limited
Statement of changes in equity
for the year ended 30 June 2015

	Note	Retained earnings	Revaluation Surplus-land	Contributed equity	Total
		NZ $	NZ$	NZ $	NZ$
Balance at 01/07/14		~~[illegible]~~ 290930	19320	144000	454250
Total comprehensive income for the year		77790	11800		89590
Proceeds from share issue*					
Distributions	*	(41480) ~~(2680)~~		(17280)	(58760)
Balance at 31/06/15		~~368840~~ 327240	31120	126720	~~523680~~ 485080.

Notes to financial statements	NZ $		
1. Revenue			
Sales	927088		
	927088		
2. Other income			
Consulting revenue	12710		
dividend received	7980		
Interest recieved	4650		
rent recieved	52920		
	78260		
3. Operating profit			
(operating profit has been determined after taking into account)			
· Auditors remuneration			
- Audit fees	10920		
- Taxation planning services	8726		
	19646		
· Donation	2690		
· Directors' fees	39480		
4. classification of expenses by nature			
Bad debts	13020		
Depreciation on property, plant, equipment	41038		
Discount on sales	2900		
employment benefit expenses	72900		
loss on disposal of manufacturing equipment	7640		
other expenses	13600		
Raw materials and consumables used	209472		
Rent paid	35400		
change in inventory	4120		

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	NZ $
9. Finance cost	
interest paid on loan	31160
	31160.

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Q4.

		DR $NZ	CR $NZ
01/07/14	1. Land	1292200	
	Land revaluation surplus		1292200
01/07/14	1. Accumulated depreciation – buildings	271840	
	Buildings		271840
01/07/14	1. Buildings	368540	
	Buildings revaluation surplus		368540
31/08/14	2. Depreciation – manufacturing plant and equipment	~~[illegible]~~ 11020	
	Accumulated depreciation – manufacturing plant and equipment		~~[illegible]~~ 11020.
31/08/14	Disposal of manufacturing plant and equipment	330600	
	Manufacturing plant and equipment		330600.
31/08/14	Accumulated depreciation – manufacturing plant and equipment	171420	
	Disposal of manufacturing plant and equipment		171420.
31/08/14	Loss on disposal of manufacturing equipment	159180	
	Disposal of manufacturing plant and equipment		159180
30/06/15	Depreciation – manufacturing plant and equipment	~~364450~~ 395400	
	Accumulated depreciation – manufacturing plant and equipment		~~364450~~ 395400.
30/06/15	Depreciation – buildings	213550	
	Accumulated depreciation – buildings		213550.

+ continued pg 19

(\$ NZD)	DR	CR
30/06/15 Land	2326000	
Cash		2326000
30/06/15 Buildings	1178000	
Cash		1178000
30/06/15 Bank	3504000	
Long term loan		3504000

* Kaihoko limited
Statement of financial position (extract)
for the year ended 30/06/15

	note	NZ$
Non-current assets		
Property, plant and equipment	1	10922990

Notes to the financial statements

1. Property, plant and equipment (NZ \$)

	Manufacturing plant, equipment	Buildings	Land	Total
For the year ended 30/06/15				
Opening carrying amount	930240 ~~930240~~	1766960	3062800	9760000
Additions	377400.	1178000	2326000	3881400
Disposals	(159180)			(159180)
Depreciation	(406120) ~~(275170)~~	(213590)		(619710)
Revaluation		368540	1292200	1660740
Closing carrying amount	742040	3099950	6681000	10922990
As at 30/06/15				
Cost or valuation	2372400.	3313500	6681000	12366900
Accumulated depreciation	(1630360)	(213550)	—	(1843910)
Closing carrying amount	742040	3099950	6681000	10922990

Journal continued. (correcting point 3)

	DR $NZ	CR NZ$
31/08/14 ~~cash~~		
~~cash manufacturing plant and~~		
31/08/14 cash	18 9 900	
manufacturing plant and equipment		169900.
31/08/14 Manufacturing plant and equipment	377400	
trade in allowance		187500
cash		189900.

continued

* Land and buildings were revalued on 1 July 2014 by Mrs J Alla, an independant valuer, to a fair value based on the market value of surrounding properties
* The ~~rev~~ gain on revaluation of land has been ~~debited~~ credited to land revaluation surplus account in equity
* The gain on revaluation of building has been credited to building revaluation surplus account in equity
* Land are buildings are mortgaged to the value of $ 3504000
* Depreciation is calculated on a straight line basis at the following rate
- Buildings 10% per annum
- Manufacturing plant and equipment 20% per annum
* Had land not been revalued, its carrying amount

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under the cost model would be $ 5388800

* Had buildings not been revalued, its carrying amount under the cost model would be $ 2741080.

only journal entries required.

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~~Q2. The first journal entry shows the remuneration bonus of $ 500000 as being an ~~expense~~ asset, with debiting remuneration in advance $500000 and crediting cash $ 50000. Asset is defined as being a result of past transaction which the entity has present control over from which inflows of future economic benefit will occur. The remuneration in advance of $ 500000 has a past transaction of the company ~~and~~ my friend works for paying the $ 500000 to the newly appointed CEO. However, the company has no present control over the remuneration paid despite the CEO si~~

Q2. The first journal entry shows the remuneration bonus to the CEO of $ 50000 being an asset with debiting $ 500000 to remuneration in advance, and crediting cash $500000. An asset is defined as being a result of past transaction of which the entity has present control over from which inflows of future economic benefit will occur. The recognition criteria of an asset is there being a probable inflow of future economic benefit, and the transaction being able to be reliably measured.

There is a past transaction of the CEO signing the five year contract, and also being paid the $ 500000 from the company. The company my friend works for has present control over the newly appointed CEO given that he/ She signed

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the 5 year contract with the company. The CEO, motivated by the remuneration package including the bonus of $500000, will set strategic goals for the company and work towards the goal of the company becoming a success from which the company will be able to generate profit. This represents inflows of future economic benefit, and thus the remuneration in advance being ~~recognized~~ defined as an asset. It can also be recognized as an asset. The value of the asset of remuneration in advance - $500000 can be reliably measured as there is the source document of the contract, and also the bank transaction history of having paid $500000 to the CEO as his / her remuneration. The CEO is likely to be highly motivated to work towards making the company a sucess and achieving great profit results, given that his / her remuneration package is very rewarding, ~~and~~ ~~from~~ in which inflows of future economic benefit is probable. Therefore, the first treatment is correct, given the remuneration in advance meets the definitions and criteria of an asset.

The second journal entry shows the payments of salary as being an expense. An expense is defined ~~as~~ by ~~increasing~~ decreases in future economic benefit in form of asset decreasing or liability increasing, and subsequently equity, thus ~~profitability~~ profit decreasing. It can also not be

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~~a contribution~~ drawings by the owner. The recognition criteria of an expense includes being able to be reliably measured, and the decrease in economic benefit being probable. The payment of salary can be defined as an expense, as the company will use cash resources to pay the salary to the CEO in which the company's asset will decrease, representing decrease in economic benefit. As a result, equity and thus profit will subsequently decrease. The salary is being paid to the CEO as part of the contract and the remuneration package. It is not drawings made by the CEO and thus it can be defined as an expense. It also meets the recognition criteria of an expense - there is the 5 year contract acting as a source document in which the salary can be reliably measured, and it is also probable that future economic benefit will decrease upon paying the salary given that cash resources are to be used. Therefore the payment of salary can be defined and recognized as an expense.

However, the entry itself is incorrect. The historical cost measurement states that all transactions must be recognized at the cost of which they occurred at. The contract outlines that the CEO will be paid an annual salary of

→ continues

Extra space if required.
Write the question number(s) if applicable.

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QUESTION NUMBER

$900000 in which the entry should be as below:

		DR	CR
31 March 2015	employment benefit expense	900000	
	Cash		900000

Altogether, the treatment of the remuneration payment is correct. However, the second treatment of the payment of salary is ~~corrected~~ correct as in being treated as an expense. However, the journal entry for it is incorrect.

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