Assessment Schedule – 2010

Scholarship Accounting (93203)

Evidence Statement

QUESTION ONE

Matching occurs when expenses are recognised in the Income Statement when incurred and they can be associated with the specific earning of revenue.

Elements
Liability definition
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.

Expense definition
Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Recognition criteria
An item that meets the definition of an element should be recognised if:

- it is probable that any future economic benefit associated with the item will flow to or from the entity AND
- the item has a cost or value that can be measured with reliability.

Discussion
Liability

- No past event
- No present obligation – company can change its mind about repairs
- No outflow of economic benefits likely
- Recognition criteria

Expense

- No decrease in economic benefits during the period
- No cost that can be measured with reliability

Application of the matching concept under this *Framework* does not allow the recognition of items in the balance sheet that do not meet the definition of assets or liabilities.

Consideration could also be given to the accrual concept.

QUESTION TWO

Vital Limited
Statement of comprehensive income for the year ended 31 March 2010

	Notes	$NZ
Revenue	1	87 560
Other income	2	23 500
Changes in inventories		4 120
Raw material and consumables used		(48 922)
Auditor's remuneration	3	(4 678)
Bad debts		(1 700)
Depreciation of property, plant and equipment		(6 890)
Director's fees		(9 400)
Donations		(2 690)
Employment benefits expense		(15 890)
Other expenses		(1 210)
Finance costs	4	(6 800)
Profit for the year		17 000
Income tax expense		5 100
Profit for the year		11 900
Other comprehensive income		
Gain on revaluation of land		6 150
Gain on revaluation of available-for-sale investment		4 200
Reclassification adjustment		(9 000)
Other comprehensive income for the year		1 350
Total comprehensive income for the year		13 250

Notes to the financial statements

1. Revenue	
Sales	87 560
2. Other income	
Dividend received	1 900
Gain on sale of available-for-sale investment	9 000
Rent received	12 600
	23 500
3. Auditor's remuneration	
Fee for audit	2 600
Fee for tax planning services	2 078
	4 678
4. Finance costs	
Interest paid	6 800

Vital Limited
Statement of Changes in Equity for the year ended 31 March 2010

	Note	Contributed equity	Revaluation surplus – land	Revaluation surplus – available for sale financial asset	Retained earnings	Total
Balance at 1 April 2009		20 000	4 600	4 800	21 650	51 050
Changes in equity for 2010						
Total comprehensive income			6 150	4 200	11 900	22 250
Reclassification adjustment				(9 000)		(9 000)
Distributions / Dividends paid					(8 000)	(8 000)
Balance at 31 March 2010		20 000	10 750	–	25 550	56 300

QUESTION THREE

(a) The answer could touch on but not be limited to issues such as:

- corporate responsibility
- how a business conducts itself
- consideration of all stakeholders
- should permeate a business from lowest- to highest-paid employees.

(b)
- improved financial performance
- increased productivity and loyalties of employees
- improved customer sales and loyalties
- growing supplier commitment
- improved environmental quality
- improved government relations (no need for specific legislation)

(c) **Purpose**
Create financial, social and environmental wealth, ie extending from goods and services produced to the way in which they are produced.

Principles
- honesty
- fairness
- caring
- courage
- display of social conscience
- harm / damage to indigenous culture

Practices
- community
- environment
- employees
- customers
- suppliers
- shareholders
- attracting ethical investors

Performance measures
Reporting on their performance in terms of those issues that have an impact on stakeholders

QUESTION FOUR

Evaluation of performance and position of *Allied Farmers Limited* for a prospective shareholder.

Return on shareholders' funds
Return on the shareholders' funds reflects the returns to the reporting entity's ordinary shareholders. The return is calculated after deducting the returns paid to loan providers (interest) and other providers of equity capital (preference shareholders). The return on the shareholders' funds is a function of profitability (after interest and taxes) that belongs to ordinary shareholders. It measures the return on the owners' investment in the reporting entity. As a rule, the higher the return, the better off the owners.

$$\frac{\text{(Net profit after tax \& preference dividends)}}{\text{average equity}}$$

	2009	2008	2007	2006
Return on shareholders' funds %	(183.3)	9.0	(11.31)	5.16
Net profit after tax	(34 198)	2 369	(2 771)	1 232
Average equity	(10 007 + 27 306) / 2	(27 306 + 25 462) / 2	(25 462 + 23 552) / 2	(23 552 + 24 172) / 2
	18 656	26 348	24 507	23 862

Over the four-year-period, this return has shown a fluctuating and decreasing trend.

Issues to consider include the number of shares issued during the period and the impairment of assets.

Financial stability
Equity to total assets (or liabilities to total assets). Fluctuating ratio that has decreased to 2.55 in the current period, primarily because of significant write-downs of intangible assets.

A significant increase in level of debt was recorded in 2009 ($171 398 million) and 2007 ($137 529 million) and 2006 ($127 117 million).

	2009	2008	2007	2006
Equity ratio	2.55	11.46	7.45	11.54
Equity	10 007	27 306	25 462	23 552
Total assets	392 355	238 256	341 583	204 054

Low ratio suggests that further debt should be avoided.

Times interest earned ratio
This ratio has fluctuated over the period and has remained in a narrow band. High level of interest payments are a cause for concern.

Times interest earned = $\frac{\textbf{EBIT}}{\textbf{interest}}$

	2009	2008	2007	2006
Surplus before tax	(33 761)	3 232	(3 349)	1 981
Interest	33 462	24 093	16 502	2 959
	(299)	27 325	13 153	4 940
Interest	33 462	24 093	16 502	2 959
Times interest earned	0.06 X	1.13X	0.80X	1.67X

Alternately, interest coverage can be calculated as operating profit before interest.

QUESTION FOUR (continued)

Dividends and earnings returns
Earnings per shares (cents). This ratio shows a fluctuating but downward trend. The loss per share for 2009 of 150 cents is concerning. A significant part of the loss for the year relates to the impairment of goodwill of $19 504 million and an increase impairment charge of $6.4 million for other assets. Over the last three years, operating revenue remained reasonably constant and showed an increase from the previous years.

Dividends per ordinary shares (cents) show a decreasing trend between 2005 and 2007. No dividends were paid in 2008 and 2009.

Dividend cover provides users with an indication of the cushion that exists to meet future dividends should earnings deteriorate. Read in conjunction with the earnings per share and dividends per share, this ratio shows a decline between 2005 and 2007.
Dividend cover (EPS / DPS) is –6.92 for 2007; 1.33 for 2006, 1.33 for 2005.

Issues from resource that could be considered and incorporated into answer
- Write down in value of assets expected in March 2010 and again in May 2010.
- Perhaps a lack of due diligence when looking at acquiring the investment companies.
- Shortage of funds to continue in operation, meaning that debt facilities need to be renegotiated.
- Payment of additional funds to Hotchin and Watson, suggesting a lack of confidence in management and a need to re-emphasise due diligence issues.
- Repayment of deposits to the Fijian property project, which will impact future cash flows as sales to those who paid deposits will not now occur.
- Downgrade credit rating of *Allied Farmers Limited*'s finance subsidiary, *Allied Nationwide Finance*.
- Qualified audit report in most recent *Allied Farmers Limited* Annual Report – going concern issues.
- Decrease in share price

QUESTION FIVE

Golden Limited
Statement of financial position at 31 March 2010

	Notes	2010 NZ$
ASSETS		
Non-current assets		
Property, plant & equipment	1	5 187 600
Current assets		
Cash		33 720
Trade and other receivables ($173 680 – $8 684)	2	164 996
Inventory	3	400 100
Total current assets		598 816
Total assets		5 786 416
LIABILITIES		
Non-current liabilities		
Long term loan	4	1 540 560
Current liabilities		
Trade and other payables	5	94 960
Current portion of long-term loan	4	110 040
Income tax payable		41 760
Total current liabilities		246 760
Total liabilities		1 787 320
NET ASSETS		3 999 096
EQUITY		
Contributed equity		2 408 400
Retained earnings ($752 250 – $8 684 – $294 080)		449 486
Revaluation surplus		1 141 210
Total Equity		3 999 096

QUESTION FIVE (continued)

Notes to the 2010 financial statement

1 Property, plant and equipment

	Land	Buildings	Plant & Equipment	Total
	NZ$	**NZ$**	**NZ$**	**NZ$**
Balance at 1 April 2009				
At cost or valuation	2 274 600	1 926 720	1 070 400	5 271 720
Accumulated depreciation		342 530	588 720	931 250
Net book value	2 274 600	1 584 190	481 680	4 340 470
Year ending 31 March 2010				
Opening book value	2 274 600	1 584 190	481 680	4 340 470
Additions	–	–	–	–
Revaluation surplus	1 125 400	15 810		1 141 210
Disposals	–	–	–	–
Depreciation	–	80 000	214 080	294 080
Net closing book value	3 400 000	1 520 000	267 600	5 187 600
Balance at 31 March 2010				
Cost or valuation	3 400 000	1 600 000	1 070 400	6 070 400
Accumulated depreciation	–	80 000	802 800	882 800
Balance at 31 March 2010	3 400 000	1 520 000	267 600	5 187 600

Depreciation is calculated on the straight line basis at the following rates:

Plant and Equipment	20% per annum
Buildings	5% per annum

The company's land and building were revalued on 1 July 2005 by B.L. Sky, an independent valuer. The valuation was based on the market value of surrounding properties. The revaluation surplus was credited to revaluation surplus in equity.

If the land and buildings were stated on the historical cost basis, the carrying amounts would be as follows:

	NZ$
Land – carrying amount	2 274 600
Buildings	
At cost	1 926 720
Accumulated depreciation (96 336 + 342 530)	438 866
	1 487 854

Acceptable alternative note disclosure:
Had land not been revalued, the carrying amount under the cost model would be $2 274 600. Had buildings not been revalued, the carrying amount under the cost model would be $1 487 854.

The land is mortgaged as detailed in Note 4.

QUESTION FIVE (continued)

Journal Entries:

Dr		Bad debts	8 684	
	Cr	Allowance for doubtful debts		8 684
		(to provide for doubtful debts @ 5% of accounts receivable)		
Dr		Long-term loan	110 040	
	Cr	Current portion of long-term loan		110 040
		(to record portion of loan due in next 12 months as a current liability)		
Dr		Land	1 125 400	
	Cr	Revaluation surplus		1 125 400
		(revaluation of land to fair value)		
Dr		Accumulated depreciation	342 530	
	Cr	Buildings		342 530
		(reversal of accumulated depreciation on revaluation of buildings)		
Dr		Buildings	15 810	
	Cr	Revaluation surplus		15 810
		(revaluation of buildings to fair value)		
Dr		Depreciation	294 080	
	Cr	Accumulated depreciation – building		80 000
	Cr	Accumulated depreciation – plant and equipment		214 080
		(Depreciation on items of property, plant, and equipment for year)		

QUESTION SIX

(a)
- Variable costs are the expenses that change directly with the production of suitcases.
- The variable cost per suitcase means that the direct costs are divided by the number of suitcases provided.
- Variable costs for producing suitcases, eg material, zip, handle, sewing machinist cost.

(b) Contribution margin per suitcase = SP – VC

70 – 40

$30

(c) Breakeven $= \frac{569\,400}{30}$

18 980 suitcases

18 980 × 70 = $1 328 600

(d) Contribution margin on producing luxury and standard suitcases

$$\frac{(30 \times 60\,000) + (20 \times 40\,000)}{60\,000 + 40\,000}$$

$= 26$

(e) Breakeven $= \frac{569\,400}{26}$

21 900 units of both luxury and standard suitcases

Luxury and standard suitcases sold / produced in ratio of 3:2 (60 000 + 40 000).

So 21 900 is 13 140 luxury suitcases and 8 760 standard suitcases.

(13 140 × 70) + (8 760 × 50)

= $1 357 800

(f)
- Breakeven point for producing both suitcases is higher than just producing the luxury suitcases, meaning more is needed to be produced to cover costs.
- Contribution margin is lower for producing both suitcases, meaning there is less to cover fixed costs.
- *Little Luggage Ltd* should also consider the quality control issues – if they use existing staff (working longer hours) to produce both types of suitcases, then there could be a drop in quality of the production of luxury suitcases.