Assessment Schedule – 2005

Scholarship Accounting: (93203)

A nine point marking scale (0-8) was used to assess each question.

Evidence Statement

QUESTION ONE: ACCOUNTING INFORMATION FOR MANAGEMENT (24 marks)

Costing Concepts (8 marks)

(a)(i) Cost Classification:

Direct manufacturing cost items:
Rubber used in ball manufacturing
Assembly-line workers' wages
** Paint colour for ball manufacturing
** Glue used in ball manufacturing

Indirect manufacturing cost items:
Factory power and lighting
Depreciation of factory machinery
Factory rental
Factory manager's salary
Oil used in machinery
Factory cleaners' wages

(NOTE: Paint colour for ball manufacturing and Glue use in ball manufacturing can be EITHER Direct OR Indirect)

(1 mark)

Judgement for 1 mark in Question One: (a)(i)
- Identifies correctly **almost all** (9–10 out of 10 items) the cost items under the appropriate cost classifications.

Judgement for 0 marks in Question 1: (a)(i)
- Identifies correctly fewer than 9 of 10 items of the cost items under the appropriate cost classifications.

Question One:
Costing Concepts (continued)

(a)(ii) There are different cost classifications to consider when reviewing different types of costs for different purposes. One of the cost classifications looks at the relationship of the cost to the product or activity. This specific type of cost classification would look at direct manufacturing cost and indirect manufacturing cost in order to relate the cost to a product or activity.

A direct manufacturing cost is a cost that is directly traceable to a product or activity. For example, rubber used in ball manufacturing is a direct material cost and can be identified directly with the production of a unit of output. You would be able to directly identify the materials used for the production of different types of balls. In addition, assembly-line workers' wages are a cost that would be classified as a direct manufacturing cost. It is a direct labour cost associated with the production of the soccer balls, assuming that the balls would be done in different production runs, and it is therefore directly traceable to how much labour was used in making different types of balls.

An indirect manufacturing cost is a cost that is not easily traceable to a product or activity. For example, factory power and lighting, depreciation, factory rental, factory manager's salary, and other types of indirect costs are costs that cannot be directly measured or traced to the production of a particular unit of output. There may be different types of balls being manufactured and it would be difficult to indicate how much of the costs were used for production of the balls. In the cases of paint colour for ball manufacturing and glue used, these can be argued to be direct costs but generally, such costs are classified as indirect manufacturing costs as it may be difficult to trace how much paint or glue was used for individual units of production. However, if different types of ball have specific types of paint or glue (perhaps one better in quality than the other and is used specially for the production of one type of ball), then such a cost could be identified as direct materials cost and classified as direct manufacturing cost.

(3 marks)

Judgement for 3 marks in Question One: (a)(ii)

- Provides an excellent explanation and / or definition of direct and indirect manufacturing costs with excellent efforts made to link the discussion to the cost items provided in the questions.

Judgement for 2 marks in Question One: (a)(ii)

- Provides a reasonable explanation and / or definition of direct and indirect manufacturing costs with reasonable efforts made to link the discussion to the cost items provided in the questions.

- Provides an excellent explanation and / or definition of direct and indirect manufacturing costs without any effort made to link the discussion to the cost items provided in the questions.

Judgement for 1 mark in Question One: (a)(ii)

- Provides a reasonable or basic explanation and / or definition of direct and indirect manufacturing costs without any effort made to link the discussion to the cost items provided in the questions.

Judgement for 0 marks in Question One: (a)(ii)

- Does not provide an adequate explanation and / or definition of direct and indirect manufacturing costs and there is no effort to link the discussion to the cost items provided in the questions.

Question One:
Costing Concepts (continued)

(a)(iii) David has focused his profit estimation only on the manufacturing costs, that is, the direct and indirect manufacturing costs associated with the production of the soccer balls. In the operation of a manufacturing firm, the owner would also need to consider the non-manufacturing costs that would be incurred in order to determine the final profit made by the firm. Non-manufacturing costs are all those costs that are not associated with the actual production of the goods but are important to ensure the smooth running of the manufacturing firm. Such costs include general and administrative costs, selling costs and financial costs.

General and administrative costs include the salaries of the General Manager, Office Clerical staff, Rental or Depreciation of the Office Building area, Depreciation of Office Equipment, Supplies used by general staff, Power and Lighting, and Maintenance of Office Building. Most manufacturing firms would require such general and administrative support to ensure that the firm is in smooth running order.

Selling costs are also important costs that will be incurred by a manufacturing firm. These costs include advertising costs, salesperson salaries, depreciation of delivery vehicles and other selling costs. It would be pointless for a manufacturing firm to make all their products and not have a good sales team to ensure that the products sell well to earn a profit.

Financial costs would cover interest costs of the firm if it has bank overdrafts or bank loans.

(4 marks)

Judgement for 4 marks in Question One: (a)(iii)
- Provides an excellent explanation on the issue of non-manufacturing costs with excellent efforts made to illustrate what these might be for a manufacturing organisation.

Judgement for 2–3 marks in Question One: (a)(iii)
- Provides a reasonable explanation on the issue of non-manufacturing costs with reasonable efforts made to illustrate what these might be for a manufacturing organisation.
- Provides a basic explanation on the issue of non-manufacturing costs with excellent efforts made to illustrate what these might be for a manufacturing organisation.

Judgement for 1 mark in Question One: (a)(iii)
- Provides an explanation on the issue of non-manufacturing costs without any effort made to illustrate what these items might be for a manufacturing organisation.

Judgement for 0 marks in Question One: (a)(iii)
- Does not provide any adequate explanations.

Total: 8 marks

Question One:
Cost–volume–profit analysis (16 marks)

(b)(i) Break-even points

$$\text{Break-even (units)} = \frac{\text{Fixed cost}}{\text{Sales price per unit} - \text{Variable cost per unit}}$$

$$\text{UCM \%} = \frac{\text{UCM}}{\text{Sales price per unit}} \times 100$$

Soccer Balls

$$\text{BE (unit)} = \frac{\$210\,000}{(\$30 - \$9)} = \frac{\$210\,000}{21}$$

BE (unit) = 10 000 units

BE ($) = 10 000 × $30

BE ($) = $300 000

Soccer Uniform

$$\text{BE (unit)} = \frac{\$825\,000}{(\$100 - \$45)} = \frac{825\,000}{55}$$

BE (unit) = 15 000 units

BE ($) = 15 000 × $100

BE ($) = $1 500 000

Or using the unit contribution margin (UCM) % to calculate BE ($)

Soccer Balls

$$\text{BE (\$)} = \frac{\$210\,000}{\frac{21}{30} \times 100}$$

$$= \frac{210\,000}{70\%}$$

$$= \frac{210\,000}{0.7}$$

$$\text{BE (\$)} = \$300\,000$$

Soccer Uniform

$$\text{BE (\$)} = \frac{\$825\,000}{\frac{55}{100} \times 100}$$

$$= \frac{825\,000}{55\%}$$

$$= \frac{825\,000}{0.55}$$

$$\text{BE (\$)} = \$1\,500\,000$$

Findings:

Soccer Balls
This product has a lower break-even point. To break even, 10 000 units need to be sold and $300 000 of sales needs to be earned. This product has a UCM % of 70% towards the covering of fixed costs.

Soccer Uniform
This product has a much higher break-even point, particularly in BE ($). To break even, we need 15 000 units and $1 500 000 in sales. This is because soccer uniforms have a substantially higher level of fixed costs ($825 000). This product has a lower UCM % of 55%.

The overall finding is that the soccer uniform business would be a much riskier venture because of the higher required levels of break-even and lower UCM %. The soccer uniform business would require a larger amount of cash to get started ($825 000 compared with the $210 000 for soccer balls), and it would require a substantial amount of revenues ($1.5 million compared with $0.3 million for soccer balls) before even reaching break-even.

(4 marks)

Judgement for 4 marks in Question One: (b)(i)

- Clear detailed working provided for calculations. If answers are correct, detailed working calculations (as above) are not required.
- Provides an excellent explanation on the BE findings and provides a strong and clear indication as to which business venture was more risky and why.
- Need to have all calculations correct for **4 marks**.

Judgement for 2–3 marks in Question One: (b)(i)

- Clear working provided for calculations. If answers are correct, working calculations (as above) are not required.
- Provides a reasonable explanation on the BE findings and provides a reasonable indication of which business venture was more risky.
- Need to have all calculations correct for **3 marks** but the explanation is not at an outstanding level. Note that if there are errors in the calculation then the candidate might be able to score **2 marks** if they have provided a good explanation, or **3 marks** if they have provided an excellent explanation.

Judgement for 0–1 mark in Question One: (b)(i)

- Working provided for calculations but may have some incorrect calculations.
- Provides a basic explanation on the BE findings and explains, but not very clearly, why one business venture was more risky than the other. The strength of their discussion-type questions might still enable them to achieve **1 mark** even though their calculations might be wrong.

Question One:
Cost–volume–profit analysis (continued)

(b)(ii) Profitability Assessment

Soccer Balls		Soccer Uniforms	
	50 000 units		40 000 units
Sales ($30 per unit)	**$1 500 000**	**Sales ($100 per unit)**	**$4 000 000**
Less Variable Costs		**Less Variable Costs**	
Direct labour ($1.50 per unit)	75 000	Direct labour ($11.50 per unit)	460 000
Direct materials ($2.50 per unit)	125 000	Direct materials ($15.50 per unit)	620 000
Variable overheads ($5 per unit)	250 000	Variable overheads ($18 per unit)	720 000
Total variable costs	**450 000**	**Total variable costs**	**1 800 000**
Contribution Margin	**1 050 000**	**Contribution Margin**	**2 200 000**
Less Fixed Overhead Costs	**210 000**	**Less Fixed Overhead Costs**	**825 000**
Profit	**$840 000**	**Profit**	**$1 375 000**
Profit % (Return on Sales %)	**56%**	**Profit % (Return on Sales %)**	**34.38%**

Profitability %
The Soccer Ball venture would give a higher Profit % return of 56% compared with the Soccer Uniform venture of 34.38%. If we used the Profit % return to evaluate which venture would be more profitable, we would decide to invest in the Soccer Ball venture.

Revenue and Profit in dollar amounts
However, if we were to look at the amount of revenue generated from the soccer uniform venture, we would be getting $4 million in sales revenue compared with only $1.5 million in the soccer ball venture. In addition, the overall profit of $0.84 million for the soccer ball venture compared with the $1.375 million in profits for the soccer uniforms venture would imply that the latter would bring in more cash for David.

(4 marks)

Judgement for 4 marks in Question One: (b)(ii)
- Clear detailed working provided for calculations. If answers are correct, detailed working calculations (as above) are not required.
- Provides an excellent explanation on the Profitability % and profit assessment with regards to which business venture was doing better. An excellent candidate should be able to bring out very clearly that the dollar amounts show a substantial difference in how much would be made with the soccer uniform business venture. However, an excellent candidate might also argue for the soccer ball product because of the lower BE point, higher UCM % and profitability %, implying less risk when compared with the soccer uniform product.
- Need to have all calculations correct for **4 marks**.

Judgement for 2–3 marks in Question One: (b)(ii)
- Clear working provided for calculations. If answers are correct, working calculations (as above) are not required.
- Provides a reasonable explanation on the Profitability % and profit assessment with regards to which business venture was doing better.
- Need to have all calculations correct for **3 marks** but the explanation is not at an outstanding level. Note that if there are errors in the calculation (or if the Profit % calculation is missing) then the candidate might be able to score **2 marks** if they have provided a good explanation.

Judgement for 0–1 mark in Question One: (b)(ii)
- Working provided for calculations but may have some incorrect calculations.
- Provides a basic explanation on the Profitability % and profit assessment with regards to which business venture was doing better.
- The strength of their discussion-type questions might still enable them to achieve **1 mark** even though their calculations might be wrong

Total 8 marks

Question One:
Cost–volume–profit analysis (continued)

(c)(i) **Cash Budget for first year of operation**

	Budget (40 000 units)	**Actual (16 000 units)**
Cash Inflow:		
Cash investment by owner	**$200 000**	**$200 000**
Cash from Sales	**$4 000 000**	**$1 600 000**
Total Cash Inflow	$4 200 000	$1 800 000
Less Cash Outflow:		
Variable Costs:		
Direct Labour ($11.50 per unit)	**460 000**	**184 000**
Direct Materials ($15.50 per unit)	**620 000**	**248 000**
Variable Overheads ($18 per unit)	**720 000**	**288 000**
Total Variable costs	$1 800 000	$720 000
Fixed Overhead Costs ($825 000 – 150 000 (Depn))	**$675 000**	**$675 000**
Total Cash Outflow	$2 475 000	$1 395 000
Cash Surplus	$1 725 000	$405 000

(3 marks)

Bolded figures = figures to be considered for errors, ie 6 errors per budget and 6 errors per actual.

Error relates to figures only (ie not 'stem').

IF all figures are correct but Cash Surplus is incorrect = one error for budget and one error for actual

Judgements for 3 marks in Question One: (c)(i)
- Cash budget prepared perfectly. No errors. Clear detailed working provided for calculations. If answers are correct, detailed working calculations (as above) are not required. Need to have all calculations correct for **3 marks**.

Judgement for 2 marks in Question One: (c)(i)
- Cash budget has 6 or fewer errors. Clear working provided for calculations. If answers are incorrect or unclear as to what the inflow or outflow is, then they are to be regarded as errors in calculation.

Judgement for 1 mark in Question One: (c)(i)
- Cash budget has 12 or fewer errors.

Judgement or 0 marks in Question One: (c)(i)
- Cash budget has more than 12 errors.
- (eg wrong answers and no workings)

Question One:
Cost–volume–profit analysis (continued)

(c)(ii) Should Beckham close his soccer uniform manufacturing business?

Beckham should not close his manufacturing business. The soccer uniform business is making sales of 16 000 units and this is above the break-even point of 15 000 units. He is making a contribution of $880 000 ($1.6 million less total variable cost $720 000) towards covering fixed costs. He is therefore making a profit of $55 000 (Sales $1.6 million less total variable cost $720 000 less total fixed overhead costs $825 000 = $55 000 and a 3.44% profit %).

While the cash budget shows a significant difference in cash surplus between the budgeted 40 000 units and the actual sales of 16 000 units, Beckham should not close his business in the short term because of this difference. The cash budget using the actual sales of 16 000 units shows a cash surplus of $405 000 or $205 000 if we take away the cash investment by the owner. This cash surplus and profit shows that in the short term Beckham is covering his fixed and variable costs adequately and that there are no real problems with his business venture, except that the actual sales did not meet the forecasted sales expectations provided by the consumer market research survey.

Beckham would need to investigate why the actual sales figure was 16 000 units compared with the 40 000 units forecasted by the market survey. He would need to see whether more money should be spent on promoting his product in order to increase his total sales revenue and profits for the longer term. If in the longer term sales and profits cannot be increased, and Beckham decides that the profit return of 3.44% is inadequate, then he may still need to decide whether or not to close the soccer uniform business.

(5 marks)

Judgement for 5 marks in Question One: (c)(ii)

- Provides an excellent explanation as to why Beckham should continue to operate his soccer uniform business in the short term. Excellent use made of relevant break-even and budget information to support his discussion. Need to have all calculations correct in order to achieve **5 marks** for this part of the question.

Judgement for 3–4 marks in Question One: (c)(ii)

- Provides a reasonable explanation as to why Beckham should continue to operate his soccer uniform business in the short term. Some good use made of relevant break-even **and** budget information to support his discussion.
- Note that the candidate might not have all calculations correct, but if the explanation appears to be at an outstanding level then they could score **4 marks**. Note that if there are errors in the calculation then the candidate might be abler to score **3 marks** if they have provided a good explanation.

Judgement for 1–2 marks in Question One: (c)(ii)

- Provides a basic explanation as to why Beckham should continue to operate his soccer uniform business in the short term. Some use made of relevant break-even **and/or** budget information to support his discussion.
- Note that candidates might have made some incorrect calculations in (c)(i), but the strength of their discussion-type questions might still enable them to achieve **2 marks**.

Judgement for 0 marks in Question One: (c)(ii)

- Candidate has not answered the question adequately in any way and the cash budget is completely incorrect.

Total 8 marks

QUESTION TWO: FINANCIAL REPORTING ISSUES (24 marks)

(a)(i) The Statement of Accounting Policies is a requirement under the Financial Reporting Standard FRS-1, Disclosure of Accounting Policies.

Paragraph 5.1 of this standard indicates:

5.1 General purpose financial reports shall include a clear and concise statement of all accounting policies adopted by an entity in the preparation of its financial reports, where such accounting policies are material to those financial reports.

Paragraph 5.5 of the standard indicates what the statement of accounting policies should include:

- identification of the entity reporting by name and nature (including the statutory base where applicable)
- the measurement system adopted
- reliance on going-concern and use of the accrual basis
- policies for the measurement / valuation of: depreciation, accounts receivable, inventory, non-current assets
- a statement of changes (or no changes) in accounting policy.

Paragraph 5.11 of the standard indicates where there are changes in accounting policies further disclosures must be made.

5.11 Where a change made in an accounting policy has a material effect on the financial position, financial or service performance, or cash flows, the following shall be disclosed:

(a) the nature of the change;
(b) the reason for the change;
(c) the effect of the change on the financial position, financial or service performance, or cash flows.

Reporting entities need to disclose information that is significant and material that is likely to influence the decision making of users of that information. The Statement of Accounting Policies requires such information either by its nature or amount to be disclosed.

(5 marks)

Judgement for 5 marks in Question Two: (a)(i)

- Provides an excellent discussion on the requirements for a reporting entity with regards to the Statement of Accounting Policies under FRS-1.

Judgement for 3–4 marks in Question Two: (a)(i)

- Provides a reasonable discussion on the requirements for a reporting entity with regards to the Statement of Accounting Policies under FRS-1.

Judgement for 1–2 marks in Question Two: (a)(i)

- Provides some discussion on the requirements for a reporting entity with regards to the Statement of Accounting Policies under FRS-1.

Judgement for 0 marks in Question Two: (a)(i)

- Candidate does not know the requirements for a reporting entity with regards to the Statement of Accounting Policies under FRS-1.

Question Two:
Financial Reporting Issues (continued)

(a)(ii) It is important that a stakeholder of a reporting entity read the Statement of Accounting Policies in conjunction with the other financial statements provided in the financial reports, because this statement **indicates the accounting policies that were used by the reporting entity in the preparation of its financial statements.**

Knowing the accounting policies that were used by the reporting entity would allow the stakeholder to **understand how some of the figures were derived** in the financial statements. This would enhance the insights that the stakeholder has on the entity's performance and position.
(Understandability)

In addition, the statement of accounting policies would indicate to the stakeholder whether or not the reporting entity has used accounting policies that are consistent with those used by **the entity in previous reporting periods.**
(Same accounting policies or changes; comparability same entity, previous periods)

Also able to compare with **other entities in the same time period.**
(Comparability)

(3 marks)

Judgement for 3 marks in Question Two: (a)(ii)
- Provides an excellent discussion on the importance of the stakeholder reading the disclosures provided in the Statement of Accounting Policies. (Include THREE of the above points for 3 marks)

Judgement for 2 marks in Question Two: (a)(ii)
- Provides a reasonable discussion on the importance of the stakeholder reading the disclosures provided in the Statement of Accounting Policies. (Include TWO of the above points for 2 marks)

Judgement for 1 mark in Question Two: (a)(ii)
- Provides some discussion on the importance of the stakeholder reading the disclosures provided in the Statement of Accounting Policies. (Include ONE of the above points for 1 mark)

Judgement for 0 marks in Question Two: (a)(ii)
- Candidate is unable to explain the importance of the stakeholder reading the disclosures provided in the Statement of Accounting Policies. (Include ONE of the above points and no discussion)

Total 8 marks

Question Two:
Financial Reporting Issues (continued)

(b)(i) It is important to have statutory regulations and reporting requirements like the New Zealand Companies Act 1993 and the New Zealand Financial Reporting Act 1993 because they provide a **regulatory framework for reporting entities**. These are two of the three main statutes that cover the formation, operation and accounting requirements of companies. The third statute is the Securities Act 1978.

Statutory and reporting requirements will ensure that consistent and credible information is provided in required reports by entities. The **standardisation of accounting practices** via reporting requirements helps the preparers of financial reports to provide relevant, understandable, reliable and comparable information in those reports. These are important qualitative characteristics that will allow users to feel confident in using these reports for important decision making.

(2 marks)

Judgement for 2 marks in Question 2: (b)(i)

- Provides an excellent discussion on the importance of statutory regulations and reporting requirements.

Judgement for 1 mark in Question 2: (b)(i)

- Provides a reasonable discussion on the importance of statutory regulations and reporting requirements.

Judgement for 0 marks in Question 2: (b)(i)

- Student is unable to answer the question.

Question Two:
Financial Reporting Issues (continued)

(b)(ii) Companies Act 1993

The Companies Act 1993 covers the **formation and operations of companies** and refers to both the Financial Reporting Act 1993 and the Securities Act 1978. The Companies Act **covers regulations on the procedures for** company formation and share issues, the appointment and duties of directors, requirements for disclosure of information to shareholders and audit requirements, the solvency test with regard to distributions to shareholders and the keeping of accounting records. **A definition of what a company is**, is provided in this Act. Section 15 of the Companies Act 1993 defines a company as a legal entity in its own right separate from its shareholders and (the entity) continues to exist until it is removed from the New Zealand Companies Register.

Financial Reporting Act 1993

The Financial Reporting Act 1993 covers the financial reporting requirements of all companies. Section 11 of the Financial Reporting Act 1993 requires that the financial statements of a reporting entity comply with **generally accepted accounting practice**. The Act covers **all companies regardless of the size and structure of ownership** within the companies. The Financial Reporting Act 1993 is important because it provides the **legislative backing to accounting standards** through the establishment of the Accounting Standards Review Board (ASRB). The ASRB's role is to approve financial reporting standards that are submitted to it by the Financial Reporting Standards Board (FRSB). The FRSB is a special board of the Institute of Chartered Accountants of New Zealand and is part of the accounting standard-setting process.

(6 marks)

Judgement for 5–6 marks in Question Two: (b)(ii)

- Provides an excellent discussion on the requirements of the Companies Act 1993 **and** the Financial Reporting Act 1993.

Judgement for 3–4 marks in Question Two: (b)(ii)

- Provides a reasonable discussion on the requirements of the Companies Act 1993 **and / or** the Financial Reporting Act 1993.

Judgement for 1–2 marks in Question Two: (b)(ii)

- Provides very limited discussion on the requirements of the Companies Act 1993 **and / or** the Financial Reporting Act 1993.

Judgement for 0 marks in Question Two: (b)(ii)

- Candidate is unable to answer the question.

Total: 8 marks

Question Two:
Financial Reporting Issues (continued)

(c) According to paragraph 6.5 in the Statement of Concepts, materiality is where:

A statement, fact, or item is material if it is of such a nature or amount that its disclosure, or the method of treating it, given full consideration of the circumstances applying at the time that the financial reports are completed, **is likely to influence users of financial reports in making decisions or assessments.**

An example is also provided in paragraph 6.5:

For example, unusual increases in directors' or elected members' emoluments may be critical (because of the fiduciary responsibilities of those directors or officials), even though the absolute amounts of those emoluments may be much smaller than many other costs which do not need to be disclosed.

The determination of whether or not an item has materiality significance is a matter of judgement. However, the judgement needs to give careful consideration as to how the omission, misstatement or non-disclosure of a relevant and reliable item of information might affect the perception and decision-making of financial report users.

The financial, non-financial and narrative information to be provided in final reports needs consideration of the materiality issue. For example, an organisation being sued for a significantly large amount of money because it was being charged with providing defective goods and polluting the environment would need to disclose this information. This information should be judged to have materiality significance because of the potential impact on the performance and position of the organisation.

Materiality is therefore an important issue for companies measuring performance and position, because it relates to the importance of events that are most likely to have an influence on the decision-making process of stakeholders.

(8 marks)

Judgement for 7–8 marks in Question Two: (c)

- Provides an excellent discussion on the materiality concept as explained in the Statement of Concepts, and provides good examples of items that might be considered 'material' for decision- making purposes. There is clear explanation of the importance of materiality in relation to its influence on the decision-making process.

Judgement for 5–6 marks in Question Two: (c)

- Provides a reasonable discussion on the materiality concept as explained in the Statement of Concepts, and provides satisfactory examples of items that might be considered 'material' for decision-making purposes. There is some explanation of the importance of materiality in relation to its influence on the decision-making process.

Judgement for 3–4 marks in Question Two: (c)

- Provides some discussion on the materiality concept as explained in the Statement of Concepts, and provides some examples of items that might be considered 'material' for decision-making purposes.

Judgement for 1–2 marks in Question Two: (c)

- Provides very limited discussion on the materiality concept as explained in the Statement of Concepts, and is unable to provide examples of items that might be considered 'material' for decision-making purposes.

Judgement for 0 marks in Question Two: (c)

- Candidate is unable to answer the question.

Total 8 marks

QUESTION THREE: COMPANY REPORTS – INTERPRETATION AND ANALYSIS (24 marks)

(a) Evaluation of Performance and Position of The Warehouse Group for a shareholder.

(i) **Profitability**

Operating margin % shows a significant decline from 10.4% in 2000 down to 5.4% by the year 2004. This will cause significant concerns to the shareholder as declining profitability levels would impact on the returns that she can earn from her investment in this company.

Tax paid return on average net assets %: The high 40.1% return experienced in 2000 has decreased to 17.4% by the year 2004. This implies that the company may have acquired investments and assets that are not providing them with increased revenues and profits.

(ii) **Liquidity**

Current assets to current liabilities: This ratio is at an acceptable level and has improved from its 2000 position of 1.05:1 to 1.47:1 in 2004. The years 2001, 2002 and 2003 showed more favourable liquidity ratios, particularly where they were above the ideal ratio of 2:1. However, the 1.47:1 ratio in 2004 shows that the company has no problems with its short-term liquidity position in that the company can meet its short-term debts.

(iii) **Financial Stability**

The **Equity to total assets** ratio shows that the company has increasing debt levels. The conservative levels of 50% for Equity to total assets indicate debt would be equal to equity. The Equity to total assets ratio shows that by 2004, the company is geared by 59.4% through debt. This would be a risky ratio for the company to have in light of its declining profitability.

Net interest cover (times) show that although the ratio has decreased from 23.6 ×, the company still has a ratio of 6.6 × which appears acceptable, as it indicates that the company still has 6.6 times in profits to cover interest repayments. However, the declining trend would need to be closely monitored otherwise the company could head into financial difficulties.

(iv) **Dividends and Earnings Returns**

Ordinary dividend per share (cents): This ratio shows that despite the decreasing profitability ratios, the company has continued to pay an increasing dividend to its ordinary shareholders. The ratio has increased from 12.5 cents to 14.5 cents by the year 2004. This may imply that the company is trying to keep its shareholders happy and encourage them to stay with the company despite its falling profitability.

Earnings per share (cents): This ratio shows a fluctuating trend over the 5-year period. In the year 2000, it was 24.3 cents and peaked at 27 cents in the year 2002 but by 2004, the ratio had decreased to 20 cents. This trend is similar to the profitability ratios and raises concern as to the future directions of the company in terms of its stability.

Question Three:
Company Reports – Interpretation and Analysis (continued)
(a) Evaluation … (continued)

(v) **Recommendation**

Without other information, I would be quite concerned about the shareholder's investment in this company. The company shows increasing risk in terms of its debt gearing. This increased debt risk has not been compensated by increasing profitability ratios. While the short-term liquidity ratio shows that the company has no short-term solvency issues, it is important to note that overall its profitability and financial stability ratios are showing unfavourable trends. If the shareholder were prepared to take the risk because of constant dividend returns, then she would need to be careful in the future in that the ratios would need to improve to reduce the riskiness of holding shares in this company.

(8 marks)

Judgement for 7–8 marks in Question Three: (a)

- Excellent discussion on findings on the profitability, liquidity, financial stability, and dividends and earnings return of the company based on the analysis and interpretation of the given financial information. (NOTE: **ALL** four areas **are** required and candidates have correctly identified the ratios under the appropriate areas.)
- **A high level of relevant accounting and business language is used and rationale or explanation of the reasons for changes in figures is given.**
- **Some rationale or explanation (as above) linked back to the Warehouse activities**
- **Specifically addresses any areas of concern for the shareholder**.
- An excellent and clear recommendation is made to the shareholder and should identify clearly concerns, if any, about the company's profitability, liquidity, financial stability and dividends and earnings return of the company.

Judgement for 5–6 marks in Question Three: (a)

- Good discussion on findings on the profitability, liquidity, financial stability, and dividends and earnings return of the company based on the analysis and interpretation of the given financial information. (NOTE: **ALL** four areas are required and candidates have correctly identified the ratios under the appropriate areas.)
- However, if the candidate has discussed three areas well, and provided an excellent recommendation (the same criteria for 7–8 marks but with 3 areas + recommendation), this may also earn the candidate 5–6 marks.
- **A good level of relevant accounting and business language is used and rationale or explanation of the reasons for changes in figures is given.**
- **Specifically addresses any areas of concern for the shareholder.**
- A clear recommendation is made to the shareholder and should identify concerns fairly clearly, if any, about the company's profitability, liquidity, financial stability and dividends and earnings return of the company.

Judgement for 3–4 marks in Question Three: (a)

- Satisfactory discussion on findings on the profitability, liquidity, financial stability, and dividends and earnings return of the company based on the analysis and interpretation of the given financial information. (NOTE: **Minimum of three out of four** areas are required but candidates may not have correctly identified the ratios under the appropriate areas or even structured their discussion under the appropriate areas.)
- If candidate has provided three areas well (as per criteria for 5–6 marks), with no recommendation, they may be considered for 3-4 marks
- Demonstrates ability to use relevant accounting and business language and explain the reasons for changes in the figures given.
- Is able to identify some areas of concern for the shareholder.
- A satisfactory recommendation is made to the shareholder and should identify some concerns, if any, about the company's profitability, liquidity, financial stability and dividends and earnings return of the company.

Judgement for 1–2 marks in Question Three: (a)

- Limited discussion on findings on the profitability, liquidity, financial stability, and dividends and earnings return of the company based on the analysis and interpretation of the given financial information. (NOTE: Candidates may not have correctly identified the ratios under the appropriate areas or even structured their discussion under the appropriate areas.)

Judgement for 0 marks in Question Three: (a)

- Candidate is unable to answer the question.

NOTE: Part (a) of Question Three should be marked in a holistic manner to decide achievement level. Non-financial justifications may be included to support the findings, but should not comprise the whole answer as the question required financial analysis.

Total 8 marks

Question Three:
Company Reports – Interpretation and Analysis (continued)

(b)(i) Profit measurement

Under Generally Accepted Accounting Practices (GAAPs), the accrual basis is used in profit measurement. The financial results extracted from the "Ten Year Review" information were derived from the Statement of Financial Performance and the Statement of Financial Position for the company. The accrual basis assumes that transactions are to be recognised and recorded in the accounting period in which they occur whether or not cash has been received or paid. Because of this assumption, the manner in which profit is measured would look at the events that affect the entity's performance and position for a particular accounting period. This means that the profit determined using this assumption does not necessarily focus on the cash effect of the transactions that might have occurred in a particular accounting period. For instance, cash might have been received in this period but because it may be cash for revenues to be provided in the future, the determination of revenues earned and therefore profits for this period would need to exclude this amount, until a subsequent period in which the revenues have actually become earned through the provision of the goods or services to the customer. In addition, in determining the profit under the accrual basis, depreciation is an expense that has to be recorded. The Cash Flow Statement would not record depreciation as a cash outflow even though it is recorded as an expense under accrual basis; there is no actual cash outflow for depreciation expense.

The Statement of Cash Flows focuses on the cash inflow and outflow movements for an entity. The movement of cash does not take into consideration whether or not the cash was received or paid for an item that relates to a different accounting period. For instance, the entity may receive cash from customers (accounts receivable) owing from a previous accounting period. Because the cash is received in this accounting period, the Statement of Cash Flows will record the cash inflow under operating activities for this period, even though it was for a credit sale from the last period. The manner in which the Statement of Cash Flows is prepared will present information about how much cash there is in the entity. This statement is not a profit measurement statement that follows the underlying assumptions of preparing financial reports. This statement is about cash inflows and cash outflows under the three categories of operating, investing and financing activities.

Therefore, there will be a difference in how much profits are determined using GAAPs and the amount of net cash inflows from the operating activities of the business.

(4 marks)

Note:

Profit calculated on an accrual basis
Includes non-cash items
Includes items that only relate to current financial period

Cash flow is all cash transactions
May/will include cash from more than one period
Includes items not considered in the calculation of profit, eg
    both capital and revenue cash expenditure
    cash drawings

Judgement for 4 marks in Question Three: (b)(i)

- Excellent discussion on why the profit amount is different from the net cash inflow amount from operating activities. Clearly identifies that the accrual basis needs to be followed under GAAPs, and explains this concept well with excellent examples that illustrate why the two amounts would be different.

Judgement for 3 marks in Question Three: (b)(i)

- Good discussion on why the profit amount is different from the net cash inflow amount from operating activities. Identifies that the accrual basis needs to be followed under GAAPs, and explains this concept adequately with good examples that illustrate why the two amounts would be different.

Judgement for 2 marks in Question Three: (b)(i)

- Satisfactory discussion on why the profit amount is different from the net cash inflow amount from operating activities. May identify that the accrual basis needs to be followed under GAAPs, and explains this concept with satisfactory examples that illustrate why the two amounts would be different.

Judgement for 1 mark in Question Three: (b)(i)

- Limited discussion on why the profit amount is different from the net cash inflow amount from operating activities. Did not identify that the accrual basis needs to be followed under GAAPs or explain this concept with satisfactory examples that illustrate why the two amounts would be different.

Judgement for 0 marks in Question Three: (b)(i)

- Candidate is unable to answer the question.

Question Three:
Company Reports – Interpretation and Analysis (continued)

(b)(ii) Solvency and cash position using the 2003 and 2004 information provided in the Statement of Cash Flows for The Warehouse Group

The Statement of Cash Flows indicates the cash movements that took place in the organisation over a particular period of time and are summarised into three different categories: operating, investing and financing activities. Overall, the cash position has decreased from $17 169 000 (2003 year) to $13 712 000 for the year 2004.

The Warehouse is generating positive cash inflows from operating activities, $83 145 000 in the year 2003 and this has increased to $88 592 000 in 2004. There is an increase in negative cash outflows for investing activities from $89 430 000 in the year 2003 to $110 684 000 in 2004. There was $119 458 000 spent in the purchase of property, plant and equipment assets in 2004, which implies continuous growth / expansion plans by The Warehouse Group. Cash flows from financial activities were positive in 2003 and 2004, due possibly to the substantial borrowings of $52 163 000 (long term in 2003) and $110 375 000 in 2004. $45 584 000 in dividends was paid to shareholders in 2004.

Overall, it does not appear that The Warehouse Group has any solvency problems even though the closing cash balance has decreased by $3 457 000. The company has increased its cash inflows from operating activities by $5 447 000 and this implies that its investing activities are having an overall positive impact on the operations of the firm.

(4 marks)

Judgement for 4 marks in Question Three: (b)(ii)

- Excellent discussion and findings on cash flows.
- Report uses appropriate accounting and business terminology.

Judgement for 3 marks in Question Three: (b)(ii)

- Clear discussion and findings on cash flows.
- Report uses appropriate accounting and business terminology.

Judgement for 2 marks in Question Three: (b)(ii)

- Satisfactory discussion and findings on cash flows.

Judgement for 1 mark in Question Three: (b)(ii)

- Limited discussion and findings on cash flows.

Judgement for 0 marks in Question Three: (b)(ii)

- Candidate is unable to answer the question.

Total 8 marks

Question Three: Company Reports – Interpretation and Analysis (continued)

(c)(i) Other types of information for evaluation of The Warehouse Group:

While the usage of financial information is a powerful and useful analytical tool for evaluating the performance and position of a business, it will only tell part of the story. We need to use other sources of information (ie non-financial information) in addition to the financial statements. The financial reports are prepared by the organisation under investigation and will always be prepared to show the most positive light on the affairs of the company. The using of financial information should be balanced with information from independent sources. Other information should be taken into account such as the state of the economy, any major changes in the industry the organisation operates in, and any uncontrollable events to which the business is susceptible. For instance, The Warehouse Group's investment into the Australian market is having significant impacts on its profits. This information does not show up in the financial statements and unless the individual has kept up with **stock market reports or media reports**, he / she would be missing a very important piece of information. If we do not take account of these additional issues we could be misled by the financial statements.

(4 marks)

Judgement for 4 marks in Question Three: (c)(i)

- Excellent discussion on the other types of information for evaluation, and addresses the importance of this evaluation for the shareholder. Excellent use of the newspaper extracts provided in the question and / or other external relevant information to illustrate the case for other types of information to be used.

Judgement for 3 marks in Question Three: (c)(i)

- Good discussion on the other types of information for evaluation, and addresses adequately the importance of this evaluation for the shareholder. May use examples to illustrate the case for other types of information to be used.

Judgement for 2 marks in Question Three: (c)(i)

- Satisfactory discussion on the other types of information for evaluation by the shareholder.

Judgement for 1 mark in Question Three: (c)(i)

- Limited discussion on the other types of information for evaluation by the shareholder.
- Provides a list of other types of information, but with no discussion

Judgement for 0 marks in Question Three: (c)(i)

- Candidate is unable to answer the question.

Question Three: Company Reports – Interpretation and Analysis (continued)

(c)(ii) Explanation for why the share prices of the company have not been doing so well in the New Zealand share market.

It seems from the newspaper extracts that The Warehouse Group's investment in Australia (Yellow Sheds) is generating losses there. The losses in Australia have caused the overall profits for the company to fall by 18.6% for the year ended 1 August 2004. The announcement that the company has been scaling back its Australian expansion because of the widening losses caused the share prices to fall, according to Jaquiery in The Dominion Post of the 11 September 2004.

The article in The Dominion Post of 10 November 2004 indicated that share prices fell by 19 cents for the October quarter after an announcement by the company that its Red Sheds sales had fallen by 2.6% for that period. Also, the item in The New Zealand Herald of 13 November 2004 said that the share price of The Warehouse had fallen, and that the company's Yellow Sheds were struggling. The article noted: "Problems linked to The Warehouse's years of rapid growth have come home to roost. The stores have grown haphazardly, making it hard for customers to find what they are looking for."

More recent (2005) news items on the Warehouse Group indicate that the company is considering selling off its unprofitable Yellow Sheds and that although they would make a significant loss on the sale of this investment, the company would be able to improve on its profitability.

(4 marks)

Judgement for 4 marks in Question Three: (c)(ii)

- Excellent discussion on why the share prices of The Warehouse Group have not been doing very well in the New Zealand share market. Excellent use of the newspaper extracts provided in the question to support their answer. Candidate may also bring in other excellent relevant information of their own to demonstrate their knowledge of what has been happening with The Warehouse Group.

Judgement for 3 marks in Question Three: (c)(ii)

- Good discussion on why the share prices of The Warehouse Group have not been doing very well in the New Zealand share market. Good use of the newspaper extracts provided in the question to support their answer. Candidate may also demonstrate their knowledge of The Warehouse Group by bringing in relevant information.

Judgement for 2 marks in Question Three: (c)(ii)

- Satisfactory discussion on why the share prices of The Warehouse Group have not been doing very well in the New Zealand share market. Some reference made to the newspaper extracts provided in the question to support their answer. Candidate may also show some of their own knowledge of The Warehouse Group by bringing in general information about the company (but not very relevant to the question).

Judgement for 1 mark in Question Three: (c)(ii)

- Limited discussion on why the share prices of The Warehouse Group have not been doing very well in the New Zealand share market. No references made to the newspaper extracts provided in the question to support their answer. The candidate does not provide any knowledge of their own about The Warehouse Group.

Judgement for 0 marks in Question Three: (c)(ii)

- Candidate is unable to answer the question.

Total 8 marks

Judgement Statement

An aggregate mark of 72 from nine questions was used in Accounting.
In 2005, candidates who achieved 45-72 marks were awarded outstanding scholarship and candidates who achieved 35-44 marks were awarded scholarship.