Assessment Schedule – 2011

Scholarship Accounting (93203)

Evidence Statement

QUESTION ONE

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.

Dr Provision for repairs and maintenance	4 150
Cr Repairs and maintenance	4 150

Profit for the reporting period would increase, current liabilities (provision for repairs and maintenance) would decrease, taxation expense and tax payable would increase. Current ratio would improve.

Quality of answer considered in marking.

QUESTION TWO

There were a number of acceptable approaches taken to this question. The following points were common.

Undermines true and fair view.

Pro-forma results should be treated with scepticism. There have been examples in recent financial history that have shown pro-forma results being used to hide fraud.

Use of IFRS enhances comparability. IFRS is to create a common worldwide accounting standard so companies in different countries can be compared with one another. Not subject to the whim of individual directors.

Inadequate accounting compliance usually plays a large role in any financial boom and bust.

Investors can be easily misled when accounting standards are not followed.

See other points in the resource including, but not limited to:

- Lack of confidence in IFRS's by companies
- Payment of bonuses paid to directors on basis of normalised earnings
- Removing one-off events like Christchurch earthquake improves predictive ability.

QUESTION THREE

Illberight Limited
Cash flow statement
For the year ending 31 December 2011

	2011 New Zealand $000
Cash flow from operating activities	
Cash was provided from:	
Receipt from customers ($245 + $1 910 - $270)	1 885
Cash was applied to:	
Payment to suppliers [$210 + ($290 + $1 105 - $240) - $195]	(1 170)
Payment for administration ($475 - $45 -12 + $12 - $16)	(414)
Payment for selling expenses ($158 + $31 - $24)	(165)
Payment for finance costs	(12)
Payment for income tax ($31 + $40 - $45)	(26)
Net cash outflow from operating activity	98
Cash flow from investing activities	
Cash was provided from:	
Sale of plant and equipment	51
Cash was applied to:	
Purchase of land	(220)
Purchase of equipment ($220 + $87 - $90)	(217)
Net cash outflow from investing activities	(386)
Cash flow from financing activities	
Cash was provided from:	
Proceeds from share issue	200
Increase in loan payable	150
Cash was applied to:	
Dividends paid	(30)
Net cash inflow from financing activities	320
Net increase in cash	32
Cash at 1 January 2011	404
Cash at 31 December 2012	436

Illberight Limited
Reconciliation of profit for the year to operating cash flows
For the year ending 31 December 2011

	2011 New Zealand $
Profit for the year	120
Add / less items classified as investing/financing activities	
Loss on disposal of plant and equipment	12
Add / less non-cash items	
Depreciation	45
Add / less movements in working capital	
Increase in inventory	(50)
Increase in accounts receivable	(25)
Decrease in prepaid expenses	4
Decrease in accounts payable	(15)
Decrease in accrued expenses	(7)
Increase in tax payable	14
Net cash inflow from operating activities	98

QUESTION FOUR

(a) $50 per machine hour
(b) $40 per direct labour hour
(c) A cost driver links the overhead costs, in a systematic way, to the product

Richardson Ltd uses machine hours as the cost driver in the Machining Department because there is a cause and effect link between changes in the level of machine hours and changes in Machining Department overhead costs.

(d) (i)

Work In Progress – Finishing Department	3 520
Work in Progress – Machining Department	3 520

Transfer of Job 228 from Machining Department to Finishing Department

(ii)

Finished Goods	4 610
Work in Progress – Finishing Department	4 610

The completion of Job 228

(e) (i) 2 200 000 applied overhead
2 240 000 actual overhead
$40 000 under applied

(ii) 1 040 000 applied overhead
980 000 actual overhead
$60 000 over applied

(f) *Richardson Ltd* General Ledger
Factory Overhead Control

Date	**Particulars**	**Debit**	**Credit**	**Balance**
2011				
31 Dec	Expenses	3 220 000		3 220 000 Dr
	Work in Progress – Machining		2 200 000	1 020 000 Dr
	Work in Progress – Finishing		1 040 000	20 000 Cr
	Cost of goods sold	20 000		–

(g) *Richardson Ltd* will take the factory overhead budget for 2011 and compare it with actual factory overhead figures for 2011.

In the Machining Department actual overhead expenses were 12% higher than budgeted factory overhead, so *Richardson Ltd* will look closely at the detail of the overhead costs in the Machining Department to see where the increase has occurred.

In the Finishing Department the actual overhead expenses were 2% lower than budgeted factory overhead. This is good but *Richardson Ltd* will check the detail of the factory overhead in the Finishing Department to ensure that one area has not still been significantly higher but this has been covered by a savings/reduction elsewhere.

Richardson Ltd will use the detailed factory overhead budget and the actual figures to help them prepare 2012's factory overhead budget.

QUESTION FIVE

Brilliant Limited
Statement of financial position at 31 July 2011

	Notes	2011 New Zealand $
ASSETS		
Non-current assets		
Property, plant and equipment	1	7 999 980
Current assets		
Cash		386 790
Trade and other receivables ($277 900 – $13 895)		264 005
Inventory		640 160
Total current assets		1 290 955
TOTAL ASSETS		9 290 935
LIABILITIES		
Non-current liabilities		
Long-term loan		2 087 100
Current liabilities		
Trade and other payables		151 900
Current portion of long-term loan		231 900
Income tax payable		66 800
Total current liabilities		450 600
Total liabilities		2 537 700
NET ASSETS		6 753 235
EQUITY		
Contributed equity		3 372 000
Retained earnings		1 362 535
Revaluation surplus		2 018 700
TOTAL EQUITY		6 753 235

Brilliant Limited
Statement of Changes in Equity for the year ended 31 July 2011

	Note	Contributed equity New Zealand $	Revaluation surplus – land New Zealand $	Revaluation surplus – buildings New Zealand $	Retained earnings New Zealand $	Total New Zealand $
Balance at 1 August 2010		3 197 000	1 800 000	–	1 203 600	6 200 600
Changes in equity for 2011						
Total comprehensive income			(216 000)	434 700	218 935	437 725
Contribution from owners		175 000				175 000
Distributions / Dividends paid					(60 000)	(60 000)
Balance at 31 July 2011		3 372 000	1 584 000	434 700	1 362 535	6 753 325

Although not asked for, the liabilities section has been provided here for completeness.

Notes to the 2011 financial statement

1 Property, plant and equipment

	Land	**Buildings**	**Plant and Equipment**	**Total**
	New Zealand $	**New Zealand $**	**New Zealand $**	**New Zealand $**
Balance at 1 August 2010				
At cost or valuation	4 985 000	2 890 000	1 712 600	9 587 600
Accumulated depreciation		524 700	883 100	1 407 800
Net book value	4 985 000	2 365 300	829 500	8 179 800
Year ending 31 July 2011				
Opening book value	4 985 000	2 365 300	829 500	8 179 800
Additions	–	–	–	–
Revaluation (deficit) surplus	(216 000)	434 700		218 700
Disposals	–	–	–	–
Depreciation	–	56 000	342 520	398 520
Net closing book value	4 769 000	2 744 000	486 980	7 999 980
Balance at 31 July 2011				
Cost or valuation	4 769 000	2 800 000	1 712 600	9 281 600
Accumulated depreciation	–	56 000	1 225 620	1 281 620
Balance at 31 July 2011	4 769 000	2 744 000	486 980	7 999 980

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

- Plant and Equipment 20% per annum
- Buildings 2% per annum

The company's land and building were revalued on 1 August 2010 by R.R. Towes, 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:

	New Zealand $
Land – carrying amount	3 185 000
Buildings	
At cost	2 890 000
Accumulated depreciation ($524 700 + $57 800)	582 500
	2 307 500

Acceptable alternative **note disclosure**:

- Had land not been revalued, the carrying amount under the cost model would be $3 185 000
- Had buildings not been revalued, the carrying amount under the cost model would be $2 307 500.

The land is mortgaged as detailed in Note 5.

Journal Entries:

Dr		Bad debts	5 215	
	Cr	Allowance for doubtful debts		5 215
		(to provide for doubtful debts @ 5% of accounts receivable)		
Dr		Long-term loan	231 900	
	Cr	Current portion of long-term loan		231 900
		(to record portion of loan due in next 12 months as a current liability)		
Dr		Revaluation surplus	216 000	
	Cr	Land		216 000
		(revaluation of land to fair value)		
Dr		Accumulated depreciation	883 100	
	Cr	Buildings		883 100
		(reversal of accumulated depreciation on revaluation of buildings)		
Dr		Buildings	434 700	
	Cr	Revaluation surplus		434 700
		(revaluation of buildings to fair value)		
Dr		Depreciation	398 520	
	Cr	Accumulated depreciation – building		56 000
	Cr	Accumulated depreciation – plant and equipment		342 520
		(Depreciation on items of property, plant, and equipment for year)		

QUESTION SIX

Investor ratios

Earnings per share

Measures the earnings attributable to ordinary shareholders on a share-by-share basis. It signals the company's earnings ability to the market. Would prefer to see growth over time but has fluctuated widely over period of analysis. Loss per share due to significant impairment losses written off in UK and US market. (See resources)

Dividends per share

The total amount declared as dividends for each ordinary share. Provides an indication of cash return that an investor receives from holding shares in the company. Although a useful measure of return, investors also want to see growth. Market price per share however decreased significantly from high of $3.49. (See resources)

Dividend payout ratio

Measures the proportion of earnings paid out to shareholders in the form of dividends. Fluctuated widely.

Dividend yield

Measures rate of return to investors based on current market price. This must be compared to the yield available on alternative investments to assist investors evaluate whether their investment objectives are being met. It is important to investors who seek to maximise the dividend return from their investments.

Price earnings ratio

Shows the number of years' earnings the market is inputing into the price of ordinary shares. It is a multiple of current or prospective earnings and reflects the confidence that the market has in the ability of the company to generate earnings in the future. The higher the P/E ratio the greater the confidence in the future earnings power. Investors would generally be willing to pay more for shares with a higher P/E ratio. (See resources)

Profitability ratios

Return on assets

Is a measure of business performance. It expresses the relationship between the profit generated by the business and the assets used to generate that profit. Useful to compare different segments. Wholesale and direct and Australian provides greatest return. Recognised that US market difficult. (See resources).

Net profit margin

Measures operating performance without being influenced how business financed. Useful to compare the different business segments. Wholesale and direct business provides best returns.

Return on equity

Measures returns owners receive for their investment. A higher return would be preferred. Increased in current year after falls. (See resources for reasons)

Interest cover

Ratio considers the reliability of profit and cash flows because lenders are concerned with the ability of the firm to service its borrowings. Indicates a margin of safety that the entity has in meeting its interest payments.

General

Would investors have confidence in a company where a director has been associated with a failed finance company and investigations are continuing?

Workings

Investor ratios	**2010**	**2009**	**2008**	**2007**
Earnings per share	15.3	(16.0)	10.3	14.13
Dividends per share	9.00	6.50	8.50	8.75
Dividend payout ratio (earnings attributable to ordinary shareholders ÷ Dividends to ordinary shareholders)	58.98	(40.57)	83.14	61.32
Earnings attributable to ordinary shareholders	*25 502*	*(26 739)*	*17 079*	*23 542*
Dividends to ordinary shareholders	*15 040*	*10 848*	*14 200*	*14 437*
Dividend yield (Dividends per share ÷ market price per share)	4.89	4.06	5.59	2.51
Dividends per share	9.0	6.5	8.50	8.75
Market price per share	1.84	1.60	1.52	3.49
Price earnings ratio	12.03	(10)	14.76	24.70
Market price per share	1.84	1.60	1.52	3.49
Earnings per share	15.3	(16.0)	10.3	14.13

The ratios and meaning merely provided as background. Examiners focused on how candidates made use of the resources including the financial and nonfinancial information provided, as well as any research undertaken by them.