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93203Q

NEW ZEALAND QUALIFICATIONS AUTHORITY
MANA TOHU MĀTAURANGA O AOTEAROA

New Zealand Scholarship
Accounting, 2004

9.30 am Thursday 18 November 2004

QUESTION BOOKLET

Answer ALL questions.

Write all your answers in the Answer Booklet 93203A.

Show ALL working.

Check that this booklet has pages 2–9 in the correct order and that none of these pages is blank.

YOU MAY KEEP THIS BOOKLET AT THE END OF THE EXAMINATION.

Outcome Description

Students will demonstrate higher level critical thinking through the integration and application of accounting concepts and skills. Students will be required to display comprehensive content knowledge, and effective communication skills, in a variety of contexts including complex or unfamiliar / unexpected contexts, relating to the entities.

Scholarship Criteria

The student will:
- within a conceptual framework, identify, process and report financial information and evaluate and justify the accounting treatment of information contained in financial reports
- interpret financial reports for external users, demonstrate critical thinking and present justified conclusions
- synthesise and apply accounting knowledge and processes in the preparation and interpretation of information for management.

Scholarship with Outstanding Performance Criteria

The student will:
- communicate effectively, demonstrating an outstanding level of critical and flexible thinking.

You are advised to spend three hours answering the questions from this booklet.

Instructions to Candidates:

- Ignore GST in this examination.
- Answer ALL questions.
- Show ALL working.
- Begin the answer to each new question (but not part of a question) on a NEW page.
- Question Three (a) has a special answer sheet, which is located as a fold-out sheet at the back of your answer booklet.

Analysis of Paper:

Question One	Accounting Information for Management
Question Two	Financial Reporting Issues
Question Three	Company Accounts – Interpretation and Analysis

QUESTION ONE: ACCOUNTING INFORMATION FOR MANAGEMENT

PART A: Cost behaviour

Ben Frodo is studying social sciences at university. He finds his weekly allowance from Mum and Dad doesn't go far and he wants to earn some extra cash. He notices that his fellow students are always eating snacks and seem to be hungry. Ben decides to lease a gas barbecue and operate a daily sausage sizzle from Monday to Friday for the university teaching period of 30 weeks.

The following information relates to Ben's sausage sizzle venture:

- Lease for the barbecue for 30 weeks will be $100.
- The university will charge $10 a week for the barbecue space utilised.
- Each sausage will be wrapped in a slice of bread with a squeeze of tomato sauce and is to be sold for $1.

Ben's friend Joel Pippin, who is studying accounting, tells him he needs to be aware of the importance of contribution margin analysis and break-even levels of production before he can expect to make any profit. Joel provides Ben with the following breakdown of costs:

Variable costs	**Variable costs per unit**
Direct labour	$0.15
Direct materials	$0.25
Variable overheads	$0.20
Fixed costs	**Total fixed cost**
Fixed overhead	$400.00

Ben has no idea what Joel is talking about.

Study the above information and answer the following questions.

(a) Explain to Ben what Joel means by variable costs and fixed costs. Use examples from Ben's sausage sizzle venture to help illustrate your explanations.

(b) Discuss the break-even concept. Explain to Ben why it is important for him to understand the break-even point related to the running of his sausage sizzle venture.

(c) On some days Ben feels that he is not selling many sausages. He thinks that he should have a rest on those days. Explain the contribution margin and why it is important that Ben has his sausage sizzle venture going every day.

PART B: Cost–volume–profit analysis

The following information is provided for Ben Frodo's sausage sizzle venture:

Sales price	**Price per unit**
Price per sausage (unit)	$1.00
Variable costs	**Variable costs per unit**
Direct labour	$0.15
Direct materials	$0.25
Variable overheads	$0.20
Fixed costs	**Total fixed cost**
Fixed overhead	$400.00

Study the above information and answer the following questions.

(a) Calculate the required break-even number of sausages in units and sales dollars. Show your workings clearly.

(b) Ben has a profit target of $5 000 and he only sells sausages on weekdays. How many sausages must he sell in total over the 30-week period to earn his profit target? On average, how many sausages is this per day?

(c) In his first year, Ben sold 15 000 sausages. Joel has been doing some business research for Ben's sausage sizzle venture for the following year. He has established the following likely changes in costs:

- Direct labour and direct materials will increase by $0.03 per unit.
- Variable overhead will increase by 10%.
- The university will charge an extra $2 per week.
- Purchase of a barbecue and gas bottle for $1 000. The barbecue is to be depreciated using the straight line method for 5 years, with a residual value of $400.

(i) Assuming that Ben sells the same number of sausages in his second year and keeps his selling price at $1 per sausage, use the information above to prepare a comparative profit statement for Ben's sausage sizzle venture showing clearly:

- his first year's contribution margin and profit
- his second year's predicted contribution margin and profit.

(ii) Explain to Ben why his predicted profitability will change for the second year.

(iii) Identify and explain some strategies that Ben could use to increase his profitability in the second year so that he could achieve the target profit of $5 000. Include both financial and non-financial information in your explanations.

PART C: Partnership and Budgeting

Ben has decided to continue in business and has given his business a name: *Frodo's Magic Sizzles*. Joel has suggested that he join Ben in partnership, since he has been providing so much business advice. Joel feels that he should receive a share of the profits and he also wants to be paid a fixed salary of $6 000 per year. Joel explains to Ben that he can cover this additional cost by increasing the price of his sausages from $1 to $1.30. Ben is not so sure. He wants to find out what his predicted weekly cash flow would be if he accepts Joel's suggestion. He conducts his own research on variable and fixed costs and provides the following weekly forecasts and other relevant information for the 2005 academic year.

Week	**Estimated Number of Sausages**
One	550
Two	500
Three	540
Four	510
Five–Thirty	Average 525

Expected price and costs	
Price per sausage (unit)	$1.30
Variable costs per unit	
Direct labour (increased by $0.05 per unit)	$0.20
Direct material (increased by $0.04 per unit)	$0.29
Variable overhead (increased by 15% per unit)	$0.23
Total fixed costs	
Joel's salary	$6 000
university space (now at $12.50 per week)	$375
Depreciation on new barbecue (5 years estimated life and a residual value of $300)	$140

The university has demanded that the space be paid for in full in advance in the first week. The new barbecue costing $1 000 will be paid for in two equal instalments, the first instalment in the first week and the second instalment a month later. Joel wants to be paid his salary in equal payments each Friday over the 30 weeks of the academic year. All other receipts and payments will occur in the week they are earned or incurred. Ben will invest $500 cash in the business at the start of the 2005 academic year.

Study the above information and answer the following questions.

(a) Prepare a weekly cash budget for *Frodo's Magic Sizzles* for the first TWO weeks of the 2005 academic year. Show clearly the estimated receipts and payments for each week. Show the cash surplus or deficit for each week and Ben's expected bank balance at the end of the second week.

(b) (i) Prepare a predicted annual profit statement for 2005.

(ii) Ben wants to know if he should have Joel as a partner. Evaluate for Ben the financial implications of having Joel as a partner. Conclude your evaluation with a justified recommendation as to whether or not Ben should have Joel as a partner.

QUESTION TWO: FINANCIAL REPORTING ISSUES

General purpose financial reports are prepared for external users. The requirements for what is presented in these reports are determined by regulation. The Companies Act 1993 indicates that reporting entities are required to comply with the Financial Reporting Act 1993. The Financial Reporting Act 1993 requires compliance with generally accepted accounting practice.

The following information on Air New Zealand has been extracted from various sources.

Air NZ forecasts fail the test

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Roland Van Den Bergh in *The Dominion Post,* 12 April 2003, Edition 2, page 3.

Airline survival 'dependent on staff cuts'

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Graeme Kennedy in *The National Business Review*,17 October 2003, pages 1–2.

NOTE: In this question the Institute of Chartered Accountants of New Zealand's Statement of Concepts for General Purpose Financial Reporting is referred to as the Statement of Concepts.

Study the information on page 6 and answer the following questions.

In 2001, the New Zealand Government had to provide Air New Zealand with an $885 million cash injection in order to rescue Air New Zealand from bankruptcy (*The National Business Review:* 15 February, 2002). Further headlines in 2003 indicated that Air New Zealand may again be heading into financial difficulties.

(a) The going-concern assumption is one of the assumptions in the Statement of Concepts. Paragraph 5.1 states that, unless there are special circumstances, preparers of financial reports should apply this going-concern assumption. Explain implications of the going-concern assumption in the preparation of financial statements.

(b) The Statement of Concepts indicates that information provided should meet the qualitative characteristics of:

- relevance
- reliability
- understandability
- comparability.

However, there are other factors that influence the application of these qualitative characteristics. These influences are:

- the balance between qualitative characteristics
- the balance between benefit and cost
- materiality
- prudence.

Given the financial difficulties and possibility that Air New Zealand might have been facing bankruptcy, it could be argued that the assets in the Statement of Financial Position of Air New Zealand Ltd should be recorded at net realisable values.

With regards to each of the qualitative characteristics, explain why it might be inappropriate for Air New Zealand to use net realisable values for measuring its assets. Your explanation should include a discussion of the other factors that might have an influence on the information provided by the company in meeting these qualitative characteristics.

QUESTION THREE: COMPANY ACCOUNTS – INTERPRETATION AND ANALYSIS

The following (simplified) extracts have been taken from the 2003 Annual Report of Air New Zealand Ltd.

Consolidated Statement of Financial Performance for the year ended 30 June

(NZ$: Dollars in millions)	**2003**	**2002**	**2001**
Operating revenues	**3,617**	4,424	7,960
Operating expenses	**(3,384)**	(4,457)	(8,014)
Earnings before interest and taxation	**233**	(33)	(54)
Interest expense	**(13)**	(78)	(227)
Earnings before taxation and unusual items	**220**	(111)	(281)
Unusual items	**4**	(243)	(1,277)
Earnings before taxation	**224**	(354)	(1,558)
Taxation expense	**(58)**	34	148
Earnings after taxation	**166**	(320)	(1,410)

Consolidated Statement of Financial Position as at 30 June

(NZ$: Dollars in millions)	**2003**	**2002**	**2001**
Total current assets:	**1,371**	1,436	2,791
Investments	**22**	37	52
Other assets	**108**	66	273
Property, plant and equipment assets	**2,199**	2,357	4,998
Total assets	**3,700**	**3,896**	**8,114**
Total current liabilities	**1,137**	1,248	3,639
Long-term debt	**1,531**	1,766	3,957
Total liabilities	**2,668**	**3,014**	**7,596**
Equity	**1,032**	882	518
Total liabilities and equity	**3,700**	**3,896**	**8,114**

Consolidated Statement of Cash Flows for the year ended 30 June

(NZ$: Dollars in millions)	**2003**	**2002**	**2001**
Cash flows from operating activities			
Cash was provided from/(applied to):			
Cash received from customers	**3,794**	4,553	7,742
Payments to suppliers and employees	**(3,210)**	(4,374)	(7,293)
Interest paid on debt	**(37)**	(123)	(303)
Tax	**(24)**		
Net cash flows from operating activities	**523**	56	146
Cash flows from investing activities			
Cash was provided from/(applied to):			
(Purchases)/sale of property, plant and equipment, net	**(225)**	58	(84)
(Purchases)/sale of investments, net	**8**	(219)	(49)
Net cash flows applied to investing activities	**(217)**	(161)	(133)
Cash flows from financing activities			
Cash was (applied to)/provided from:			
Borrowings	**242**	444	1,480
Repayment of borrowings	**(377)**	(1,093)	(1,623)
Capital contributed		584	280
Dividends paid			(81)
Net cash flows (applied to)/provided from financing activities	**(135)**	(65)	56
Net cash flow	**171**	(170)	69
Opening cash position	**594**	764	695
Closing cash position	**765**	**594**	**764**

Study the information on page 8 and answer the following questions.

(a) After reading the "Airline survival 'dependent on staff cuts'" news article in *The National Business Review* (see page 6), the bank manager requests a report from you that evaluates Air New Zealand Ltd's performance and position for the years 2003 and 2002.

Your report should provide an analysis of the:

(i) profitability

(ii) liquidity

(iii) financial stability of the company

(iv) then, make a justified conclusion as to whether the bank should continue to lend money to the company.

Your report should be based on the information provided in the financial statements. You should carry out any necessary calculations to assist in your discussion and provide such information as appendices to the report. A table (located as a fold-out sheet at the back of your answer booklet) is provided for you to complete with regards to the calculation of important analysis measures for this report.

(b) The Statement of Cash Flows will provide further evaluations of Air New Zealand Ltd for the bank manager.

(i) Explain the importance of evaluating the Statement of Cash Flows.

(ii) Conduct an analysis of the cash flows of Air New Zealand Ltd by reviewing its operating activities, investing activities and financing activities.

(iii) Identify any concerns you may have about the solvency of Air New Zealand Ltd as a result of your analysis of the company's cash flows.

(c) The Companies Act 1993 specifies certain requirements that must be met before a company may repurchase its shares from shareholders.

(i) Given the media reports (see page 6) on the financial difficulties that Air New Zealand Ltd faced, what are some of the reasons as to why Air New Zealand may want to repurchase its shares from its shareholders?

(ii) State the requirements under the Companies Act 1993 that must be met by Air New Zealand Ltd before it can repurchase its own shares.