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91177



NEW ZEALAND QUALIFICATIONS AUTHORITY
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SUPERVISOR'S USE ONLY

Level 2 Accounting, 2015

91177 Interpret accounting information for entities that operate accounting subsystems

2.00 p.m. Friday 20 November 2015
Credits: Four

Achievement	Achievement with Merit	Achievement with Excellence
Interpret accounting information for entities that operate accounting subsystems.	Interpret accounting information in depth for entities that operate accounting subsystems.	Interpret accounting information comprehensively for entities that operate accounting subsystems.

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

You should attempt ALL the questions in this booklet.

Pull out Resource Booklet 91177R from the centre of this booklet.

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

Check that this booklet has pages 2–8 in the correct order and that none of these pages is blank.

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

Excellence

TOTAL

23

ASSESSOR'S USE ONLY

Refer to **Resources A, B, and C** in **Resource Booklet 91177R** when answering the questions.

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QUESTION ONE

Perfect Pies is owned by Ashlee. The business bakes and sells pies in its shop, and also supplies pies on credit to sports clubs throughout New Zealand.

- (a) Complete the table of analysis measures below using **Resource A** and **Resource C**. (Round your answer to one decimal place where necessary, and ignore GST.)

Analysis Measures for *Perfect Pies*

Analysis Measure	2014	2015
Mark-up percentage	30%	30 %
Inventory turnover	41.3 times	45.2 times

- (b) Justify why **sales volume** is important to the profitability of a business like *Perfect Pies*. In your answer, use information from the table above and **Resource C** to explain:

- what the mark-up percentage in 2015 means for pies that cost \$3 to produce, and the **amount** of gross profit on **each** pie
- the meaning of the inventory turnover in 2015
- why it is important that with a low mark-up percentage, *Perfect Pies* has a high inventory turnover
- how the trend in inventory turnover has contributed to improved profitability.

• The markup percentage of 30% in 2015 for *Perfect Pies* means that 30% of the cost price of a pie is added back to the cost price in order to calculate the selling price for a pie that costs \$3 to produce, *Perfect Pies* will sell it for \$3.90. 90 cents of this is gross profit for each pie. This is the same as 2014's 30%.

• The inventory turnover of 45.2 times in 2015 means that *Perfect Pies* sells its equivalent average inventory on hand 45.2 times per year.

This is a good trend as it has increased from 41.3 times in 2014 indicating increased sales. which increased gross profit to \$261050 and an associated gross profit percentage.

- It is important that the inventory turnover is high when Perfect Pies has a low markup ~~as~~ as this ensures profit will be generated. This is because a low markup percentage of 30% means only a small amount of gross profit is made per sale (90 cents per \$3 pie) in order to be profitable and maximise gross profit, lots of pies will need to be sold. This is represented by a high turnover rate which indicates although perfect pies has a low markup percentage, the high turnover of 45.2 times means there is a high sales volume leading to increased profits despite a lower markup. The low markup attributes to a high inventory turnover as it attracts more customers which further increases sales and inventory turnover. Additionally, as Perfect Pies deals with food, the inventory must be turned over quick or it may go off.

- The inventory turnover increasing from 41.3 times to 45.2 times in 2015 is a good trend and contributes towards improved profitability by demonstrating an increase in sales and income and therefore, profits. For example, if the average inventory on hand

E8

QUESTION TWO

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- (a) Complete the table of analysis measures below, using **Resource A** and **Resource B**. (Round your ratio answer to two decimal places.)

Analysis Measures for *Perfect Pies*

Analysis Measure	2014	2015
Equity ratio	0.76:1	0.81 :1
Administrative expense percentage	10.3%	9%
Rate of return on total assets	8.8%	13.9%

In April 2014, Ashlee decided to invest more into her business. She wanted to improve the dining area of her shop for customers, upgrade the ovens used for cooking the pies, and improve the layout in the kitchen.

- (b) Justify why Ashlee's decision to invest more into *Perfect Pies* has been successful by:

- (i) Explaining how the equity ratio shows that Ashlee has invested more into the business.

The equity ratio for 2015 means that for every dollar of assets ^{in Perfect Pies}, 81 cents has been funded by Ashlee. This is an increase from 0.76:1 in 2014 (76 cents: \$1) which demonstrates ^{and is a good trend} Ashlee's increased investment. Only 19 cents per dollar is funded by liabilities. A high ratio means Ashlee can take advantage of debt financing. Perfect Pies is at the max of the ideal 0.5:1 to 0.81:1 //

- (ii) Explaining why the trend in the administrative expense percentage is positive, and the reason for this, using information from **Resource B** and **Resource C**.

The administrative expense percentage is a good trend from 10.3% in 2014 to 9% in 2015. The 2015 value means 9% of income from sales is spent on admin expenses such as telephone. This is 9 cents to every dollar of sales. Therefore, a decrease in this percentage means less income is being spent and more is being retained in Perfect Pies as profit. This decreasing expense is also positive as it is not at the expense of profit as it is shown to increase in 2015 to \$40500 which may also be due to the decreased expense.

- (iii) Explaining what the trend in the rate of return on total assets shows, AND how Ashlee's decision has achieved this, using information from page 4, **Resource B**, and **Resource C**.

The rate of return on total Assets in 2015 means Perfect Pies generates a 13.9% return on assets in the business (13.9 cents per dollar). This is a good trend as it increased from 8.8% in 2014. This shows Perfect Pies is using assets more efficiently than before to generate profit. Ashlee's decision to invest more in the form of \$20000 kitchen equipment has achieved this as upgrading ovens increased productivity and efficiency, as does improved kitchen layout and dining area. This was achieved through increased investment by Ashlee which also increased the equity ratio. Using Assets more efficiently increases profit which can be seen as net profit increases to \$40500 from \$22000 in 2015.

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QUESTION THREE

ASSESSOR'S
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- (a) Complete the table of analysis measures below, using **Resource A** and **Resource C**. (Round your answer to two decimal places for current ratio, and up to the nearest day for age of accounts receivable.)

Analysis Measures for *Perfect Pies*

Analysis Measure	2014	2015
Current ratio	3.17:1	3.33 :1
Age of accounts receivable	32 days	29 days

Perfect Pies credit terms are 30 days from date of delivery. Ashlee uses the following procedures to manage her accounts receivable:

- sends out monthly statements to sports clubs that order pies from her on credit
- sends out reminders for overdue accounts.

- (b) Justify why *Perfect Pies* is in a strong position in terms of liquidity. In your answer, explain:

- what the current ratio for 2015 means
- what the age of accounts receivable calculation for 2015 means
- how the procedures Ashlee uses effectively manage her accounts receivable
- how the trend in the age of accounts receivable enhances *Perfect Pies* liquidity position.

• The current ratio for 2015 means for every dollar of current liabilities, *Perfect Pies* has \$3.33 to repay them. This is within the ideal of 2:1 - 5:1 and shows *Perfect Pies* will be able to pay their short term debts as they fall due. //

• The age of accounts receivable for 2015 means it takes *Perfect Pies*' debtors on average of 29 days to repay their debts. This is a good trend as it is less than 32 days in 2014 which means *Perfect Pies* receives revenue from credit customers faster, benefiting

liquidity and the liquid ratio.

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• Ashlee's procedures effectively manage her accounts receivable as it ensures all ~~debtors~~ ^{creditors} are aware of the age and value of the credit balance through the monthly statement which allows for planning of payment and acts as a reminder. Also, sending reminders out on overdue accounts prompts payment and ensures debtors do not forget about their owing to Perfect Pies. These procedures are shown to be effective as the 29 days age of accounts receivable in 2015 shows on average, credit customers pay within Perfect Pies 30 day credit term.

• The good trend of Perfect Pies age of accounts receivable decreasing to 29 days in 2015 enhances Perfect Pies liquidity position as this shows debtors are paying the accounts faster which means increased ^{and current asset of Bank and cash flow} revenue. This increases the liquid ratio and gives better liquidity position to Perfect Pies which allows Perfect Pies to meet their immediate debts as they fall due. ~~the~~ decreased age of accounts receivable also decreases the risk of bad and doubtful debts which decreased the admin expense percentage. ~~the overall impact may also~~

Extra space if required.

Write the question number(s) if applicable.

ASSESSOR'S
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NUMBER

1B Of Perfect Pies wages 30 pies, the increased turnover trend shows approximately 120 more pies are being sold. This increase in inventory turnover is ~~see~~ a primary reason for the increased sales in 2015 to \$910000.0 and Gross profit to \$210000 which also relates to the increased net profit ~~to~~ \$40500 and an increased net profit percentage.

2Bii The decreased Administrative expense percentage also shows increased profitability as the office wages expense remains \$80000 while sales increases to \$910000 in 2015 which is a major reason for the decrease in perfect Pies Administrative expense percentage.

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Excellence exemplar for 91177 2015			Total score	23
Q	Grade score	Annotation		
1	E8	<p>The reason for a low markup requiring a high inventory turnover is well justified with an explanation that uses the fact that only 90 cents (a small amount of gross profit) is made per pie. This necessitates a high number of sales, which has caused the inventory turnover to increase from 2014 – 2015. The corresponding increased gross profit and net profit (and the dollar amounts) is justified by the inventory turnover increasing from 41.3 to 45.2 times. The strong linkages between markup, inventory turnover, gross profit, and net profit in this answer earned it the high grades</p>		
2	E7	<p>Part (ii) is well justified, with dollar amounts and the office wages remaining the same and the effect of this on profit well explained. In part (iii), the increasing rate of return is well explained as resulting from increased profit in 2015, which was a result of better assets used more efficiently. Specific reference was made to the dining room furniture and improved kitchen layout. The only thing missing for higher grades is the effect of this on the rate of return in a specific way.</p>		
3	E8	<p>This answer refers specifically to the two procedures used by <i>Perfect Pies</i> and justifies how these have more effectively enable the owner to manage her accounts receivable. The justification is made as to how the procedures bring in cash more quickly and therefore how liquidity is enhanced and <i>Perfect Pies</i> therefore has cash available to meet their current debts. It refers to the 30 day credit term that <i>Perfect Pies</i> have in place.</p>		