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91404



NEW ZEALAND QUALIFICATIONS AUTHORITY  
MANA TOHU MĀTAURANGA O AOTEAROA

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## Level 3 Accounting, 2014

### 91404 Demonstrate understanding of accounting concepts for a New Zealand reporting entity

9.30 am Friday 21 November 2014  
Credits: Four

Achievement	Achievement with Merit	Achievement with Excellence
Demonstrate understanding of accounting concepts for a New Zealand reporting entity.	Demonstrate in-depth understanding of accounting concepts for a New Zealand reporting entity.	Demonstrate comprehensive understanding of accounting concepts for a New Zealand reporting entity.

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 parts of all questions in 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 2–12 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

20

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**Notes**

- In this assessment, the New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting 2010 is referred to as the NZ Framework.
- You can use HG to refer to *Hallenstein Glasson Holdings Limited* in your answers.

**QUESTION ONE**

The extract below is from the notes to the financial statements of *Hallenstein Glasson Holdings Limited* for the period ended 1 August 2013.

**Notes to the Accounts (extract)**

*Hallenstein Glasson Holdings Limited* is a retailer of men's and women's clothing in New Zealand and Australia. *Hallenstein Glasson Holdings Limited* is a company registered under the Companies Act 1993 and is listed in the New Zealand Stock Exchange (NZX). The company is a limited liability company incorporated in New Zealand.

- (a) Explain what **limited liability** means and how this applies to the **shareholders** in *Hallenstein Glasson Holdings Limited*. Include in your answer a justification of circumstances in which limited liability may not protect a **director** (who is also a shareholder) of *Hallenstein Glasson Holdings Limited*.

Limited liability means that if HG were to fall into debt, the personal assets of shareholders in HG are protected and not at risk. Shareholders in HG are only liable for <sup>the value of shares</sup> ~~any outstanding~~ that they hold in HG, and are not liable to pay ~~at~~ more than that of HG debts. However a director in HG is liable for some of HG debt. Although they may also be a shareholder in HG their role as a director is more significant. Therefore depending on the agreements in HG company constitution, the directors personal assets may not be protected if the company falls into debt, and the director may have to sacrifice some of their personal assets for HG as well as the value of shares they hold in HG.

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- (b) Justify how the **cost constraint on useful financial reporting** (formally referred to as the balance between benefit and cost) is applied to *Hallenstein Glasson Holdings Limited* as a New Zealand reporting entity.

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~~Hatte~~ HG is a reporting entity meaning they are large (have expenses over \$30m), are publically accountable as they are listed on the NZX and issue shares to the public. HG also has governance as a board of directors govern the company on behalf of shareholders. HG prepares all necessary financial statements to comply with NZIFRS and NZGAAP, in their annual report. Because HG is publically accountable, the benefit of preparing these financial reports outweighs the cost of doing so <sup>potential</sup> as shareholders need to see these statements to decide if they want to invest in HG. As HG is governed by a board of directors who are not the only shareholders in HG

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- (c) Justify why suppliers of *Hallenstein Glasson Holdings Limited* would be interested in the Statement of Cash Flows. Include in your answer the purpose of the Statement of Cash Flows.

Suppliers of HG would be interested in seeing the company's Statement of Cash flows to see if HG has any cash flow issues. By seeing if HG ~~paid~~ cash received and cash paid for the year, they can determine whether HG has a healthy bank balance. This will help suppliers in making future decisions like will HG be able to pay their accounts on time? Therefore should the supplier sell more stock to HG on credit? Suppliers may also be interested to see if HG has paid their accounts to other suppliers that year. By looking at HG trend in their bank balances from year to year they can decide if they want to continue to supply to HG in the future.

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- (d) Justify why the PricewaterhouseCoopers auditors' report has been included in Hallenstein Glasson Holdings Limited's annual report.

The Pricewaterhouse Coopers auditors report has been included in HG annual report to show users of HG reports that they are fairly represented. The auditor's report <sup>will</sup> also impact users' decisions and is therefore relevant information. As Pricewaterhouse Coopers are <sup>an</sup> ~~an~~ outside auditor (separate from HG) users know that financial reports are not <sup>(neutral)</sup> biased. Pricewaterhouse Coopers will ensure that HG has complied with all necessary rules and regulations of NZGAAP therefore statements are complete and free from error. Users of HG financial reports can then compare these to financial reports of other companies as they give a true and fair view of HG's current financial position. The auditor's report is relevant as it will assist users in making past decisions as they will know ~~the~~ which concepts are followed when statements were prepared therefore they can see if investing in HG was a good option compared to another company. They can also make future decisions like should they continue to invest/sell/ or buy more shares in HG or another company. The auditor's report is also a statutory requirement therefore because of its nature it is material, and will aid users' understandability when interpreting HG financial reports.

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## QUESTION TWO

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## Notes to the Accounts (extract)

## Standards, Amendments and Interpretations to existing standards (extract)

There have been no significant changes in accounting policies during the year.

- (a) Explain how the above information aids **comparability** in Hallenstein Glasson Holdings Limited's general purpose financial statements for a current shareholder of the company.

The above information aids comparability as users can see that the rules and concepts applied to financial statements this year (for example depreciation on buildings was 10%) are the same as rules and concepts applied last year. Users can therefore make accurate, informed comparisons between last year's financial statements and this year's. Users will therefore know that no other factors impacted on HGR profits and equity for the year that can not be seen. Users can then compare statements from year to year to see if profit and equity has truly increased or decreased. This will aid them in decision making such as ~~A~~ should they hold, sell or buy more shares in HGR.

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- (b) Using the liability definition, justify why Taxation Payable is reported AND classified as a current liability in Hallenstein Glasson Holdings Limited's Statement of Financial Position.

~~A liability~~ Taxation Payable is a liability for H.G. as it will decrease their economic benefit in the form of cash when H.G. pays the taxed owed to the government <sup>within</sup> ~~in the~~ the next ~~next~~ accounting period, decreasing H.G. bank account.

Taxation Payable is due to a past event as Hatter H.G. generated a profit ~~in the last accounting period~~, which they had to pay tax on. Taxation payable is the ~~the~~ difference <sup>total</sup> between the tax expense and the provisional tax paid <sup>currently</sup> that has not yet been paid. H.G. is obliged to pay the government the outstanding taxation figure as it is a legal requirement of being a company.

The Taxation payable will ~~to~~ cause an outflow of economic benefit within the ~~next~~ accounting period as H.G. is obliged to pay their tax within a few months to the government. Therefore the taxation payable is classified ~~and r~~ as a current liability ~~in H.G.~~ and is reported in H.G. Statement of financial position as a current liability.

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## Notes to the Accounts (extract)

### Inventories

Inventories are stated at the lower of cost or net realisable value.

Inventory adjustments are provided at year end for stock obsolescence within cost of sales in the Statement of Comprehensive Income.

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- (c) Justify why the obsolescent stock included in *Hallenstein Glasson Holdings Limited's* inventory on balance day will be stated at the lower of cost or net realisable value.

The net realisable value of HG inventory is a more relevant figure. The net realisable value shows the actual amount of future economic benefit that is going to be received by HG when the inventory is sold. Because stock becomes obsolete, it loses value and ~~can~~ therefore has to be sold below its original cost. Therefore by reporting inventory at its net realisable value a true and fair view of HG financial position will be shown as the inventory decreasing in value will decrease future profits and equity for HG. This will help aid users in decision making for example shareholders can accurately see trends in profit figures and they can decide if it was a good idea to invest in HG? Do they think dividends will increase or decrease this year? Therefore should they hold, sell or buy more shares in HG?

For the year ended 1 August 2013, payments to suppliers amounting to \$148.3 million (rounded) are included in *Hallenstein Glasson Holdings Limited's* Statement of Cash Flows. Of this, \$2.6 million (rounded) was prepaid to suppliers for expenses that will be incurred during the year ended 1 August 2014.

- (d) Explain in detail, **using relevant amounts**, how the supplier expenses and the prepaid supplier expenses will be reported in *Hallenstein Glasson Holdings Limited's* general purpose financial statements, **other than** the Statement of Cash Flows, for the year ended 1 August 2013.

HG follows the accrual basis concept therefore transactions are recognised as they occur and reported into the period in which they relate to. HG will report payments to suppliers (COGS) as \$145.7 million in the Statement of Comprehensive Income <sup>for the year ended 1 August 2013</sup> as this is the total figure paid to suppliers that relates to buying supplies <sup>(suppliers actually received this year)</sup> for this period. ~~The~~ A current asset 'prepayments' of \$2.6m will be reported in HG statement of financial position as at 1<sup>st</sup> August 2014. This prepayment represents the \$2.6m future economic benefit that is going to be received by HG in the next accounting period when supplies are received that have already been paid for.

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### QUESTION THREE

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*Hallenstein Glasson Holdings Limited's* significant accounting policies and notes to the accounts for the period ended 1 August 2013 include the following:

#### Property, plant and equipment (extracts)

Land and buildings are recorded at valuation and are revalued at least every three years based on an independent valuation by a member of the New Zealand Institute of Valuers.

Land and buildings were revalued to fair value on 1 August 2013. Valuations were made on the basis of recent market transactions on arm's length terms. The valuations assume no major economic downturn after the date of valuation and that the properties continue to be managed and maintained in a professional manner.

The values were determined by independent valuers *Colliers International and Telfer Young (Hawkes Bay) Ltd.*

The following statement has been extracted from the Chairman's Report of *Hallenstein Glasson Holdings Limited's* annual report for the period ended 1 August 2013:

"Notwithstanding a decline in profit, the balance sheet remains strong and cash reserves stand at \$19.312 million. The Group remains debt free".

Use the information provided in the extracts above to explain how the fair value of land and buildings can be used as security over a loan. In your answer:

- justify how *Hallenstein Glasson Holdings Limited's* land and buildings measured at fair value meet the definition and recognition criteria of an asset
- justify why the fair value amount reported for land and buildings can be relied on by a bank manager when approving loan finance and how the chairman's statement is relevant information for the bank manager.

The fair value of HG land and buildings meet the definition of an asset as they create an inflow of economic benefit in the form of cash as customers buy clothing from their buildings (shops) and clothing is produced in buildings on land. When customers pay for clothing HG economic benefit increases in the form of cash into HG bank account. The fair value of land and buildings <sup>also</sup> will create an inflow of economic benefit if they were sold for their net reliable value in the form of cash into

HG bank account (the value of the land and buildings, net reliable value) HG land and buildings measured at net reliable value are due to a past event when land and buildings were originally purchased and then independent valuers revalued them on 1 August 2013 due to recent market transactions. Hallenstein glassons has present control over the land and building valued at their reliable value as they are the only ones who can decide what the land and buildings are used for and whether they are sold or not.

• The land and building measured at reliable value meet the recognition criteria of an asset as it is probable (greater than 50% chance) that the land and buildings will generate a future inflow of economic benefit for HG when clothing is made and sold in their buildings. The land and buildings will also most probably generate future economic benefit of their reliable value if sold as this should be an accurate figure determined by recent market transactions by qualified independent valuers. The current fair value figures of land and buildings are reliable as they have been determined by an independent valuer and are therefore not biased, and they can be measured with reliability by a valuation certificate (source document) stating the exact fair value figure of land and buildings.

• The fair value amount of land and buildings can be relied on by a bank manager when approving a loan finance as the figure has been determined by a professional independent valuer based on recent market transactions. The figure is therefore neutral, free from bias and can be measured with reliability by the valuation certificates.

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Extra space if required.

Write the question number(s) if applicable.

QUESTION  
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~~The bank manager~~ The chairman's statement is relevant information for the bank manager as it will state HG's future plans for expansions and how the company's cash flow and profits are. From the chairman's report the bank manager will be able to see that HG's cash reserves stand at \$19.312 m and HG is debt free. This will help the bank manager in decision making as they can estimate if HG will be able to repay the loan with interest. Therefore should the bank manager give HG the loan. As profit is declining, the bank manager will want a security increase HG does begin to have cash issues and is unable to repay the loan. By looking<sup>at</sup> the fair value of HG's assets (land and buildings) the bank manager can see if this will cover the loan and interest if HG is unable to repay the loan with cash. The bank manager will only approve the loan finance to HG if they believe the loan will be able to be repaid and if the fair value of the land and buildings covers the loan. Therefore if HG has cash flow issues they will have to sell their land and buildings and this will generate economic benefit (of their fair value) that can be used to repay the loan. The fair value of HG's land and buildings can therefore be used as a security over a loan.

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Achievement with Excellence exemplar for Accounting 91404 2014		Total score	20
Q	Grade score	Annotation	
1	E8	<p>The candidate was awarded four grades for:</p> <ul style="list-style-type: none"> <li>limited liability described, linked with a reasonable example showing how limited liability applies to <i>Hallenstein Glasson Holdings Limited's</i> shareholders (I)</li> <li>the benefit exceeds the costs of preparing general purpose financial statements/ financial statements prepared in accordance with NZ GAAP/ financial statements with full compliance to NZ IFRS is linked to <i>Hallenstein Glasson Holdings Limited</i> being an issuer / public accountability and having many users (C)</li> <li>the purpose of the Statement of Cash Flows is linked to how suppliers would use the information in <i>Hallenstein Glasson Holdings Limited's</i> Statement of Cash Flows (C)</li> <li>a valid reason explained why an auditor's report is a statutory requirement that includes how an auditor's report provides an independent opinion.(C)</li> </ul>	
2	M6	<p>The candidate was awarded five grades for:</p> <ul style="list-style-type: none"> <li>following the same accounting policies will lead to <i>Hallenstein Glasson Holdings Limited's</i> financial statements being prepared in a consistent way (I)</li> <li>explains the past event for <i>Hallenstein Glasson Holdings Limited</i> that incurred the taxation payable account (C)</li> <li>a current liability has to be within the next year/ future year/ next period (U)</li> <li>explains that inventory adjustments at year end results in obsolescent stock being valued at net realisable value as this is the probable future economic benefit to flow to <i>Hallenstein Glasson Holdings Limited</i> when sold to customers (C)</li> <li>explains the asset using the accrual basis of accounting (I)</li> </ul>	
3	M6	<p>The candidate was awarded the following five Merit grades:</p> <ul style="list-style-type: none"> <li>describes that the land and buildings have been purchased in the past by <i>Hallenstein Glasson Holdings Limited</i>, and then has been revalued to its fair value on the basis of recent market transactions on arm's-length terms of surrounding properties</li> <li><i>Hallenstein Glasson Holdings Limited</i> will benefit in the future, as land and buildings are used to earn income for the company, and the bringing of cash into <i>Hallenstein Glasson Holdings Limited</i></li> <li>reliable measure using third-party independent experts is free from bias/faithfully represents the fair value of the land and buildings</li> <li>describes ONE of an asset characteristics or recognition criteria, from a bank manager's point of view in terms of security over the loan</li> <li>describes how the reference to <i>Hallenstein Glasson Holdings Limited's</i> cash reserves in the chairman's statement influences a bank manager's decision to approve a loan</li> </ul> <p>AND</p> <p>describes how the reference to the group remaining debt free in the chairman's statement influences a bank manager's decision to approve a loan.</p>	