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91404



NEW ZEALAND QUALIFICATIONS AUTHORITY
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Level 3 Accounting, 2015

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

2.00 p.m. Monday 30 November 2015
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 the 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 2–11 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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This assessment is based on *Air New Zealand Limited's* Annual Report and Annual Shareholder Review for the period ended 30 June 2014.

QUESTION ONE

- (a) Justify the importance of the following statement, written at the bottom of *Air New Zealand Limited's* Annual Shareholder Review, for any user of this information.

"The accounting policies used in these financial statements are attached in the notes to the Annual Financial Statements."

The financial statements of Air New Zealand Limited must meet the qualitative characteristic of comparability to be correct. Comparability is judged by consistent preparation and presentation of statements, reliable comparative figures and the accounting methods which are used to prepare the statements. Changes to these methods must be disclosed to users so that they can make decisions based on true and fair documents which they understand. The notes of Air ^{New Zealand Limited} ~~NZ Ltd~~ are used to disclose actual estimates, statements like items to provide reasoning for trends, subsidiary and parent companies and the accounting methods and policies used ~~by~~ in the preparation of the statements. Therefore, the above statement is important because changes to the accounting policies could affect the users ability to compare the statements and therefore their ability to get a true and fair representation of Air ^{New Zealand Limited's} ~~NZ Ltd's~~ financial position, performance and cashflow and the reason behind trends in the figures.

Included in *Air New Zealand Limited's* Annual Shareholder Review is a report titled "We're supporting Brand New Zealand" about what the company has done to become one of the world's most environmentally sustainable airlines.

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- (b) Justify how this report could be relevant to satisfying the information needs of a current shareholder of *Air New Zealand Limited*.

An environmental report is a non statutory aspect of the financial statements for Air New Zealand Limited. It is relevant because it may help shareholders predict the future success of Air New Zealand Limited. Sustainable companies are usually more popular as they are seen to be 'environmentally friendly' and have an enhanced brand. This move could increase sales for Air New Zealand Limited so ~~may be~~ will help current shareholders to decide whether to buy more, hold or sell their shares. Because Air New Zealand is accounting for natural capital, it is likely that current shareholders will have more confidence in the 'business' future and would buy more or hold their shares.

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- (c) Justify ONE limitation of the general purpose financial statements in *Air New Zealand Limited's* Annual Report, using a specific example in your explanation.

One limitation of the general purpose financial statements is that some figures are estimated. For example, both depreciation on property, plant and equipment and doubtful debts are estimated by preparers of the statements and although based on knowledge of trends and evidence from Air New Zealand Limited, are not fully reliable. ^{due to no source documents} Depreciation is recorded as an expense in the income statements of Air NZ Ltd. meaning profit figures ~~may~~ ^{will} be affected if it is too high or too low. Depreciation is also reported in the PPE note ~~to~~ ⁱⁿ the statement of financial position meaning net assets is affected. Overall, estimates can affect the accuracy of the financial statements and could affect the users' interpretation of the financial position, performance and cashflow of Air NZ Ltd.

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QUESTION TWO

The following extracts are contained in the Annual Shareholder Review of Air New Zealand Limited for the period ended 30 June 2014.

"Our continuing fleet renewal programme means that our capital expenditure will be elevated in the coming years."

Future capital exp. ~~commitments~~

"The year finished on a very exciting note as we took delivery of our first Boeing 787-9 Dreamliner aircraft, the first of its type in the world."

"Fleet replacement programmes resulted in increased depreciation and reduced lease costs as owned aircraft replaced operating leased aircraft."

- (a) Justify why the total cost of purchasing the first Boeing 787-9 Dreamliner is capital expenditure, and explain how this aircraft provides future economic benefit for Air New Zealand Limited.

Capital expenditure is one off spending which ^{benefits a company beyond the next accounting period} creates a non current asset for Air New Zealand Limited. The cost of the Boeing ~~788~~ 787-9 Dreamliner plus one off costs to acquire the aircraft ^{for use} is reported as capital expenditure because this one off spending will benefit Air New Zealand ^{limited} for a period beyond the next 12 months. The aircraft provides future economic benefit for Air New Zealand ^{limited} because it is an asset which results in an inflow of cash to Air New Zealand Ltd. When the airline provides customers with the flying service by transporting customers from one place to another on the Boeing 787-9 Dreamliner, customers pay for the service so the use of the asset generates income through fees charged to customers for the service of flying ~~from one to~~ between places. It is a non current asset in the statements for Air New Zealand Limited for the period ending 30 June 2014 because it will generate income for the company beyond the period ending 30 June 2015 / the next period.

- (b) Justify how depreciation on the aircraft fleet reported in Air New Zealand Limited's Income Statement meets the definition of an expense.

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Depreciation on the aircraft fleet is an expense for Air New Zealand Limited because it decreases economic benefit through ~~an outflow~~ the consumption of the future economic benefit which the company could get from the aircraft fleet which occurs when the aircraft fleet is used to generate income. This decreases equity due to decreasing profit for the year and it is not a distribution to equity participants/shareholders. Even though the depreciation is not an outflow of cash, it is an outflow of an asset, the benefit which Air NZ Ltd will be able to receive from the aircraft fleet. Therefore, it is reported as an expense in the income statement for Air New Zealand Limited.

→ This decreases the carrying amount and the net realisable value of the aircraft fleet, hence decreasing assets through its property, plant and equipment.

- (c) Justify how the cost constraint on useful reporting is applied to Air New Zealand Limited as a New Zealand reporting entity.

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The cost constraint on useful reporting ~~is~~ means that the benefit of preparing the statements for Air New Zealand Limited must outweigh the costs. Air New Zealand Limited is a tier one reporting entity because it is large and publically accountable. It is large because it has expenses over \$30 mil and is publically accountable because it is listed on the NZX and issues shares to the public. Because ~~the~~ tier one entities have separate directors and shareholders, the ~~providers of capital~~ ~~are not~~ directors do not provide all the capital. Therefore, to keep Air New Zealand Limited operating, capital ~~is~~ needs to be raised through issuing shares. ~~Therefore~~ The financial statements particularly the general purpose financial statements must benefit Air New Zealand Limited through informing potential investors of ~~the~~ the opportunity to invest in Air NZ Ltd and the performance position and cash flow of the company. If the financial cost to prepare the statements exceeds benefit they receive in raising capital for future endeavors such as expansions of the aircraft fleets, the statements are not useful. ~~and~~ It would not make sense for Air New Zealand Limited to prepare the statements when the costs outweighed the benefits.

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For the period ending 30 June 2014, the fair value of Air New Zealand Limited's investment in Virgin Australia Holdings Limited was \$422 million, after being revalued downwards by \$18 million.

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- (d) Justify how an independent valuation leading to a downwards revaluation of Air New Zealand Limited's investment in Virgin Australia Holdings Limited meets the fundamental qualitative characteristic of faithful representation.

Faithful representation is judged on whether the source documents are complete, neutral and free from error and the verifiability of the statements. The fair value of the investment in Virgin Australia Holdings Limited is based on the market set price of the shares. The \$422 million fair value was determined by market supply and demand meaning that it is neutral as the ^{valuation}~~cost~~ was determined by a third party and because the fair value was determined by the ^{independent} market rather than Air New Zealand Limited, we can be sure that there is no bias in the figure. The market also has all information necessary to judge the valuation of the investment so the valuation ^{certificate} would be complete. Additionally, the certificate would be free from error because there would be no misstatements or omissions. Therefore, the ~~as~~ valuation of \$422 mil for the investment in Virgin Australia Holdings Limited could be verified by 2 or more knowledgeable and registered individuals who could come to a consensus on the valuation of \$422 mil. The \$18m decrease in fair value of financial assets is reported as ~~an other income~~ an expense in the income statement for Air New Zealand Limited and reflects an outflow of economic benefit which ~~could occur when~~ ~~it~~.

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QUESTION THREE

Air New Zealand Limited operates a loyalty programme in which customers can earn Airpoints Dollars when booking flights. For an Airpoints member, these Airpoints Dollars help to reduce the cost of buying future airline tickets and must be used (redeemed) before they expire. Airpoint Dollars are usually valid for four to five years. *Air New Zealand Limited* knows from historical experience when Airpoints members redeem their Airpoint Dollars.

The Airpoints Dollars owed to *Air New Zealand Limited's* loyalty programme members is shown by the following extract from Note 15 to the financial statements.

Note 15	2014
	\$M
Current liabilities	
Revenue in advance – Airpoints loyalty programme	101
Non-current liabilities	
Revenue in advance – Airpoints loyalty programme	143

Justify why *Air New Zealand Limited* has reported the Airpoints loyalty programme as both a current and non-current liability, using the above information.

In your answer, explain:

- ✓ how *Air New Zealand Limited's* loyalty programme meets the definition and recognition criteria of a liability
- ✓ how *Air New Zealand Limited* has applied the going concern assumption to reporting the loyalty programme as both a current and a non-current liability.

- The loyalty program meets the characteristics of a liability because it ~~they~~ resulted from a past transaction when the customers booked flights with Air New Zealand Limited and earned the Airpoint Dollars. This is reported as 'revenue in advance' because they have a present obligation to provide customers with flights when the points are redeemed. This will ~~also~~ result in an outflow of future economic benefit in the form of the air service which Air New Zealand Limited supplies when the points are redeemed and the ~~flights are~~ customers are transported from one place to another.

- The 'Revere in advance' - airpoints loyalty program is meet the recognition criteria for a liability as it has a cost/value which can be measured reliably of a total of \$244mil and it is highly probable (more than 50% chance) that the future economic benefit (airline services) will flow out from Air New Zealand Limited as no other entity will provide the ^{flight} service for customers through the Airpoint dollars. Because the members have already earned the points through booking flights Air New Zealand Limited is obliged to provide the service for the points.
- Air New Zealand Ltd has applied the going concern assumption which states that the company intends to continue operating into the foreseeable future with no intention or need to cease trading or liquidate. Therefore, by reporting non-current liabilities, Air New Zealand Limited shows that they intend to settle liabilities over a period beyond the next 12 months / accounting period ending ^{30 June} 2015. To settle the liabilities and provide flight services to customers, Air New Zealand needs to continue operating their flight service, showing their intention to continue operating into the foreseeable future.
- The revere in advance - airpoints loyalty program has been split into \$101m current (assets) and \$143m non current (assets) because Air New Zealand Limited expects \$101m worth of Airpoint Dollars to be redeemed in the next accounting period ending 30 June 2015. They know this from "historical experience"

Extra space if required.

Write the question number(s) if applicable.

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3 and therefore account for this amount of Airpoint dollars to be redeemed in the next accounting period. However, \$143m worth of airpoint dollars are expected to be retained by loyalty program members and not redeemed within the next 12 months and will be redeemed in the periods after 30 June 2015. Therefore, the liability is reported as both current and non current because the airpoint dollars are expected to be redeemed during different times/years.

→ This portion of the ~~current~~ liability is therefore reported as a non current liability. ||

Achievement with Excellence exemplar for Accounting 91404 2015		Total score	20
Q	Grade score	Annotation	
1	E7	<p>The candidate was awarded three grades for:</p> <ul style="list-style-type: none"> • users knowing the policies / assumptions / bases that have been adopted / used in the preparation of <i>Air New Zealand Limited's</i> annual financial statements to aid comparability and adds that accompanying notes provide additional detail and disclosures for users to make sound decisions (buying shares) based on <i>Air New Zealand Limited's</i> annual financial statements. (C) • a valid reason describes how the report satisfies the information needs of a current shareholder, linked to <i>Air New Zealand Limited's</i> profitability (I) • explains the limitation of the identified example (depreciation and doubtful debts) of an estimated figure, linked to the profit of <i>Air New Zealand Limited</i> not being entirely accurate (C) 	
2	E7	<p>The candidate was awarded five grades for:</p> <ul style="list-style-type: none"> • explains that the total cost of purchasing the Boeing 787-9 Dreamliner aircraft includes the costs incurred to get the aircraft into a position and condition to use for airline services which will provide economic benefit for <i>Air New Zealand Limited</i> beyond the current accounting period (C) • describes how the Boeing 787-9 Dreamliner aircraft is used to earn income and explains that ultimately the future economic benefit is cash received for <i>Air New Zealand Limited</i>. (C) • describes why depreciation on the existing aircraft fleet is an expense, and explains the decrease in economic benefit as the aircraft once used will provide less future economic benefit (C) • describes that the benefit exceeds the cost of preparing annual financial statements prepared in accordance with NZ GAAP / annual financial statements with full compliance to NZ IFRS (referred to as general purpose financial statements in answer) (I) • explains how faithful representation is satisfied by using an independent valuer to revalue <i>Air New Zealand Limited's</i> investment in <i>Virgin Australia Holdings Limited</i> (I) 	
3	M6	<p>The candidate was awarded the following five Merit grades:</p> <ul style="list-style-type: none"> • describes <i>Air New Zealand Limited</i> has a contractual obligation to honour the loyalty programme until such time the Airpoints Dollars are redeemed • describes the past event (e.g. buying a passenger ticket) earning Airpoints Dollars for members of <i>Air New Zealand Limited's</i> loyalty programme • describes the outflow of economic benefit occurs when members redeem their Airpoints Dollars, which results in less actual cash from passenger revenue into <i>Air New Zealand Limited</i> • links the description why <i>Air New Zealand Limited</i> is a going concern to the classification of liabilities as current and non-current • describes an explanation as to why the \$101 million of the loyalty programme is reported as a current liability <p>AND</p> <p>describes an explanation as to why the \$143 million of the loyalty programme is reported as a non-current liability.</p>	