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# 3

91404



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NEW ZEALAND QUALIFICATIONS AUTHORITY  
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## Level 3 Accounting, 2016

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

2.00 p.m. Friday 18 November 2016  
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**

**22**

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**Note:** This assessment is based on *Michael Hill International Limited's* Annual Report for the period ended 30 June 2015.

You can use MHI to refer to *Michael Hill International Limited* in your answers.

### QUESTION ONE

- (a) Justify why *Michael Hill International Limited* is a New Zealand reporting entity.

Michael Hill International Limited is a reporting entity as its an issuer (listed on the NZX stock exchange) so holds public accountability. It is also large in size as it employees more than 50 full time employees and the shareholders are separate to the governing body. It would also be considered a reporting entity if its total assets exceeded \$60 million and total <sup>annual</sup> income exceeded \$30 million.

*Michael Hill International Limited* donates 15% of the gross profits from the sale of the Pink Hope Collection to the Pink Hope Foundation (sponsorship programme), which supports families facing hereditary breast and ovarian cancer.

- (b) Justify why details regarding *Michael Hill International Limited's* donations to the Pink Hope Foundation are included in the Annual Report for the period ended 30 June 2015.

MHI includes their donations in the annual report so that shareholders are informed on where their money goes in terms of the companies' operations. This also shows MHI in a positive light as they are contributing to the community so will instill a sense of pride in current shareholders and encourage potential shareholders to invest as they won't then seem like a "money-hungry" corporation. Therefore this ~~use~~ information (15% of gross profits are donated to Pink Hope) is relevant to current, new and potential shareholders deciding whether to buy, hold or sell their shares in MHI.

- (c) The following statement has been extracted from the CEO's Review of Operations of *Michael Hill International Limited's* Annual Report for the period ended 30 June 2015:

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"During the year, we experienced strong e-commerce (online) sales growth of 122%. We also experienced strong levels of awareness across our digital and social channels."

Justify how this statement could be relevant to satisfying the information needs of an employee currently working in a retail store of *Michael Hill International Limited*.

(online) Information is considered to be relevant if it is capable of making a difference to the economic decisions of users. A strong sales growth of 122% is relevant to MHI employees as it shows that the company is doing well and earning more revenue which means its likely to continue operating into the foreseeable future (hence employees have job security). An increase in revenue and potentially sales may mean that employees may want to ask for a pay rise.

However strong (e-commerce) online sales might concern some employees as MHI might want to expand their online presence and cut back on employee numbers in stores. E.g. like K-Mart and New World replaced check-out operators with self-checkouts.

C

E8

**QUESTION TWO**

The extract below is taken from the notes to the financial statements of *Michael Hill International Limited's* Annual Report for the period ended 30 June 2015.

**Basis of Preparation**

The financial statements for the year ended 30 June 2015 have been prepared in accordance with New Zealand Generally Accepted Accounting Practice (NZ GAAP). They comply with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS), and other applicable New Zealand Financial Reporting Standards, as appropriate for profit-oriented entities.

**Trade and Other Receivables**

Collectibility of trade receivables is reviewed on an ongoing basis. Debts that are known to be uncollectable are written off. A provision for impaired receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables.

- (a) Justify why the financial statements of *Michael Hill International Limited* are required to comply with NZ GAAP. In your answer, you should explain what NZ GAAP refers to.

As MHI is a reporting entity it holds public accountability as to the use of shareholders' money in company operations. As shareholders are separate from the governing body they do not have a say in the day-to-day management of the company and therefore rely on MHI's general purpose financial statements. NZGAAP refers to the rules, practices, broad concepts and principles which form the basis on which general purpose financial statements are prepared. This is to ensure that MHI's financial statements show a true and fair view of the company's financial position, performance and cash flows and that the statements are complete and accurate to the best of the accountant's knowledge. MHI would prepare its Statement of Accounting Policies, Statement of Comprehensive Income, Statement of Financial Position etc. in accordance with NZGAAP and in compliance with all applicable NZIFRS rules. These financial statements would be audited to ~~ensure~~ <sup>provide</sup> an independent opinion that they follow NZGAAP and <sup>all</sup> applicable NZIFRS rules so investors and lenders can be confident in investing in or lending to MHI.

the information presented in the financial statements before //

- (b) Identify and justify the measurement base that has been applied to the reporting of *Michael Hill International Limited's* trade receivables.

Michael Hill International Limited's trade receivables have been reported at net realisable value - which is the amount of cash or cash equivalents receivable when trade receivables settle their debts assuming Allowance for doubtful debts (impairment) is written off as bad debts.

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This is a more relevant predictive value of the cash MHI will receive from trade receivables when they settle their debts as they know through past experience <sup>and age of debtors</sup> not all credit customers will repay their debts and will be written off as bad debts.

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It is probable that cash will flow from trade receivables to MHI as credit customers must repay their debts to maintain a good credit rating - however there may be some written off as bad debts. The cost of trade receivables (at net realisable value) can be measured reliably as MHI know through past experience and age of debtor the amount of cash unlikely to be received which shows faithful representation. The cost of the net realisable value however cannot be verified until the debt is collected. //

C

## Statutory Report of the Directors

### Accounting Policies

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

- (c) Justify how the above information aids comparability in *Michael Hill International Limited's* general purpose financial statements for a current shareholder of the company.

Comparability is achieved when users of financial statements can compare an entity's year-to-year financial statements or compare ~~the~~<sup>the</sup> financial statements of two companies to identify trends in financial position/performance/cash flows.

As MHI's financial statements are prepared in accordance with NZGAAP and there have been no changes in accounting policies during the year current shareholders in MHI are informed that the general purpose financial statements have been prepared consistently. This means they can easily identify trends in MHI's financial position, performance and cash flows over the years to see for example if there has been an increase in profitability and potentially dividend pay outs.

Shareholders could also compare MHI's general purpose financial statements with other reporting entities (that also follow NZGAAP) to compare which provides a better return on their investment.

For the year ended 30 June 2015, interest paid of \$4 547 000 was reported in *Michael Hill International Limited's* Statement of Cash Flows, after subtracting the amount paid for the interest owing from the previous year. On balance day, included in the accrued expenses total of \$5 772 000 was an amount owing for interest of \$161 000.

- (d) Explain in detail, using relevant amounts, how both the interest expense and the interest expense owing on balance day will be reported in *Michael Hill International Limited's* general purpose financial statements, other than the Statement of Cash Flows, for the year ended 30 June 2015.

Interest owing of \$161 000 will be added to the interest expense of \$4 547 000 to give a total of \$4 708 000 of interest expense to be reported in MHI's Statement of Comprehensive Income on balance day (30 June 2015) as this amount relates to interest owed for this accounting period.

Interest owing of \$161 000 will be reported as <sup>an</sup> accrued expense <sup>current liability</sup> (and will be included with other accrued expenses during the year) to total \$5 772 000 on balance day (30 June 2015). This is because this \$161 000 represents the cash that will be paid next accounting period, this cash ~~paid~~ once paid cannot be used elsewhere and so is an outflow of resources embodying economic benefits //

C

E8

## QUESTION THREE

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**Note:** The following has been extracted from the *Michael Hill International Limited* Annual Report for the period ended 30 June 2015.

*Michael Hill International Limited* is currently in dispute with the New Zealand Inland Revenue Department (IRD). On 30 June 2015, the issues with the IRD remain unresolved.

*Michael Hill International Limited* is under investigation by the IRD for the tax treatment adopted by the Group in relation to the financing arrangements between New Zealand and Australian group members for the last six accounting periods, from 2009 through the 2014 financial year.

The total amount of tax deductions claimed by the Group in respect of these years and that is in dispute is NZ\$35 million.

The Group continues to defend its position and has started legal proceedings in the High Court of New Zealand, with a view to this pending lawsuit being brought to a conclusion, rather than remaining unresolved.

Justify why the accountants for *Michael Hill International Limited* have shown the pending lawsuit as a contingent liability in the Notes to the Financial Statements, as opposed to a liability in the Statement of Financial Position.

In your answer, explain:

- how the pending lawsuit does not meet the definition of a liability for *Michael Hill International Limited*
- how the qualitative characteristic of relevance, including materiality, applies to disclosing the pending lawsuit in the Notes to the Financial Statements.

MHI does not have a present obligation to pay the lawsuit as the legal proceedings are currently in process and the High Court has not yet made a decision (found MHI guilty). There is no past event as the lawsuit is still pending so there is not yet a cost of the lawsuit to record (High Court has not yet decided) ~~cost~~. There is no outflow of economic benefits (cash) as MHI will not be required to pay the lawsuit until they are found guilty (lose the lawsuit).

As the pending lawsuit does not meet the definition of a liability it will not be included in MHI's Statement of Financial Position. However it is still relevant to users of MHI's financial statements and so will be included in the notes to the Statement of Financial Position as a contingent liability. This is because the lawsuit of



NZ\$35 million is material in size. If found guilty MHI will have to pay a significant amount of money to the IRD which will have a big, negative impact on their profitability and cash flows. This will concern shareholders and the bank as a decrease in profitability may effect <sup>(decrease)</sup> the dividend pay out shareholders receive. A negative impact on the liquidity situation of MHI will also concern the bank as it may effect MHI's ability to repay loans (if they currently have a loan) and may effect the security over the loan which may ~~effect the~~ <sup>effect the</sup> bank's ~~to~~ ~~decide~~ decision to lend them a loan.

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The \$35 million lawsuit is also material in nature as its the amount of tax deductions claimed by MHI over the <sup>years</sup> 2009-2014 and if found guilty may <sup>and their reputation as a business</sup> ruin their reputation in the stock market ~~as a~~ ~~As~~ ~~ps~~. This would affect their future profitability as customers may choose not to shop <sup>at</sup> ~~their~~ their stores - affecting dividend payout to shareholders. It could also influence the decisions of shareholders when deciding whether to buy, hold or sell their shares in MHI as current shareholders may not want to be associated with MHI / concerned about lower dividends next accounting period etc.

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Therefore the pending lawsuit of \$35 million is relevant, as its capable of making a difference to the economic decisions of users and hence should be included in the notes to the Statement of financial position.

m6

Achievement with Excellence exemplar for Accounting 91404 2016		Total score	22
Q	Grade score	Annotation	
1	E8	<p>The candidate was awarded three grades for:</p> <ul style="list-style-type: none"> <li>Explains how <i>Michael Hill International Limited</i> is an issuer who, as a result, has public accountability. (C)</li> <li>The details of the Pink Hope Collection sponsorship programme are linked with BOTH a user's relationship to <i>Michael Hill International Limited</i> AND to the idea of aiding comprehension. (C)</li> <li>The "information needs of a current physical store employee" is linked to their employment conditions and <i>Michael Hill International Limited's</i> online store expansion. (C)</li> </ul>	
2	E8	<p>The candidate was awarded four grades for:</p> <ul style="list-style-type: none"> <li>Compliance with NZ GAAP and the NZ IFRS is necessary because <i>Michael Hill International Limited</i> has public accountability/is relied on by shareholders to ensure a true and fair view. (C)</li> <li>Explains that the realisable value is the expected cash to be received from accounts receivable assuming that doubtful debts will be written off as bad debts, which is based on past experience. (C)</li> <li>Explains how comparability is achieved by linking the act of following the same accounting policies which will lead to <i>Michael Hill International Limited's</i> financial statements being prepared in a consistent way (C)</li> <li>Explains the interest expense AND explains the liability. (C)</li> </ul>	
3	M6	<p>The candidate was awarded the following five Merit grades:</p> <ul style="list-style-type: none"> <li>Explains that <i>Michael Hill International Limited</i> has no present obligation to pay the total amount of tax deductions claimed by the Group to the IRD and provides a reason why.</li> <li>Explains that there is no outflow of economic benefit from <i>Michael Hill International Limited</i> and provides a reason why.</li> <li>Explains why the contingent liability is relevant information for any one user of <i>Michael Hill International Limited's</i> financial statements.</li> <li>Explains an explanation as to why the contingent liability is material because of its size that it is likely to influence users of <i>Michael Hill International Limited's</i> financial reports in making decisions.</li> <li>Explains an explanation as to why the contingent liability is material because of its nature that it is likely to influence users of <i>Michael Hill International Limited's</i> financial reports in making decisions.</li> </ul>	