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SUPERVISOR'S USE ONLY

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.

Merit

TOTAL

15

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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.

MHI is a reporting entity because they are an issuer, is a large company, total assets more than 30 million, total income more than \$60 million & more than 50 ^{full time} equivalent employees in 'MHI'. As well as the fact that the Governing body (Directors) are kept separate from the (Shareholders) owners. //

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.

Donations are money from 'MHI' that goes towards a good cause. 'MHI donations' are included in the Annual report to provide a human face as well as the fact that it is also another statutory requirement (legal). This provides a human face of 'MHI' showing that what they do is real as opposed to just numbers that interested users may not be able to understand. "15% of gross profits from sales of Pink Hope" also shows 'MHI' contributions & attract potential shareholders who may be very interested in buying ^{or holding} 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*.

Information is relevant when it is capable of making a difference to the decisions of users (relevance). Employees can overlook or foresee this statement to ensure any job security or job opportunities. The employees may be at risk in terms of "in-store-sales", employees may be concerned about the stability (security) of their jobs. "strong... (online) sales growth of 122%" means that 'MHC' are gaining significant sales online & provides the employees about whether they should continue to work there as well as the fact that if they do remain to work on-store or online (IT department), employees may ask for a raise as "strong sales of 122%" means 'MHC' is very profitable (more profits) & may want to ask for a higher raise on salaries/wages. Job opportunities may also be opened in terms of profitability, delivering goods of 'MHC' which employees may want to look at delivery, or online department to ensure maximum security on their jobs & also benefit significantly from the strong sales (profitability increasing). //

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QUESTION TWO

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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.

NZGAAP is the specific rules, practices, broad concepts & principles which forms the basis on which general purpose financial statements are prepared. This ensures that it shows a true & fair view & therefore; the reporting entity 'MHL' is required to follow all applicable NZIFRS & current industry practice. Reporting entity 'MHL' complies with NZGAAP because it has public accountability which are the financial statements that are relied upon by users before making any decisions on the operations of 'MHL'. NZGAAP also allows for ^{easy} comparisons between different entities as the policies adopted in the preparation of 'MHL' general purpose financial statements are consistent.

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

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The company reports trade receivables at estimated realisable value after allowing for doubtful debts which is the probable future economic benefits in the form of cash that is likely to be received by 'MHC' from the ^{present} ~~present~~ ^{trades} ~~trades~~ receivable. This is a reliable amount as the trade receivables ~~are~~ ^{are} when customers come to settle ~~due~~ ^{due} debts with 'MHC'.

bad debts & age of accounts receivable.

This measurement base is estimated realisable value.

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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.

'MHC' has comparability because accounting policies are comparable that is the information which can be compared to different entities & the same entity, 'MHC', over different periods of time. This is so that it provides the ability to identify ^{identifies} similarities/differences/trends between 'MHC' & other of its competitive companies ^{eg trends} between profits, the differences in the cost of the expenses etc... This may only happen when the general purpose financial statements are consistently prepared. This shows that it is prepared consistently because "no changes in the accounting policies" which allows for easy comparisons to identify similarities & trends & differences between MHC & different entities over different periods of time. The current shareholder may also be at ease of identifying trends in profits of the general purpose financial statements. This also provides a basis of their informed economic decisions making on whether to buy/hold/sell their shares (as ease-efficient). C

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.

* The interest paid expenses of \$4 547 000 is added unto the \$161 000 owing for interest totalling \$4 708 000 which is the interest expense an expense reported in the Statement of Comprehensive Income of 'MHC' ~~on~~ ~~balance day~~ which the amount \$161 000 relates to ~~within~~ ^{this} period.

* \$5 772 000 is the amount after adding \$161 000 totalling the accrued expenses; a current liability reported in the statement of financial position on balance day which represents the future economic benefit that is the interest that will be paid to the expense (e.g loan) that must be paid next ^{period} ~~period~~ by 'MHC'. //

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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.

* A liability is a present obligation of 'MHC' ^{incurred} ~~incurred~~ as a result of past events, the settlement of which is expected to result in an outflow of 'MHC' resources embodying economic benefits.

* 'MHC' is not required to pay or give up some of its money ^{for the pending lawsuit} as they have no present obligation: they did not sign an agreement (loan, lease), they ~~did~~ not sign a contract (electricity invoice, wages owing) & they have had not any goods received for the IRD are not suppliers.

* There was no past event as 'MHC' did not sign or claim any obligations in the past.

* The future outflow of economic benefit however does exist as it is the money or \$35 million that flows from 'MHC' to the IRD in the form of cash that they are expected to pay the IRD (the cash (some) must be given back).

*It is probable the future economic benefit flows from the entity 'MHC' to the IRD in the form of cash as it is legal to not pay taxes & therefore if 'MHC' wants to avoid risking the shutdown of their business, they must pay the \$35 million of tax deductions to the Government (NZ) to do so.

*The cost of \$35 million however can be measured with reliability as source documents (IRD tax invoice) have come from an independent neutral 3rd party (the ^{NZ}IRD) which shows faithful representations. The IRD tax invoice (source documents) proves that a transaction has taken place & therefore verifiable. //

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Achievement with Merit exemplar for Accounting 91404 2016		Total score	15
Q	Grade score	Annotation	
1	E7	<p>The candidate was awarded three grades for:</p> <ul style="list-style-type: none"> Identifies that <i>Michael Hill International Limited</i> is a New Zealand reporting entity because the company is an issuer. (U) 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) 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) 	
2	E7	<p>The candidate was awarded four grades for:</p> <ul style="list-style-type: none"> 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) Describes 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 (I) 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) Explains the interest expense AND explains the liability. (C) 	
3	N1	<p>The candidate has correctly described only one of the characteristics of a liability of:</p> <ul style="list-style-type: none"> Describes 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. <p>The candidate has correctly defined the three characteristics of a liability.</p>	