Assessment Schedule – 2022

Accounting: Scholarship (93203)

Question ONE

Suggested solution

This is an open-ended question, with the material from the resources providing the initial point of reference.

The key in the discussion is how can chartered accountants deal with the role the accounting profession should play in combating modern-day slavery. Do the candidates recognise that accountants have a role to play? Should this be an ethical or moral issue, and therefore legislation is not required? Should they use their expertise to contribute to the drafting of any legislation? Should they use their expertise to guide companies in developing appropriate disclosures?

Judgement

	Score	
Outstanding Scholarship	**7, 8**	Draws on the resource material and produces and effectively communicates an outstanding and sophisticated analysis that demonstrates a high level of perception and insight in their critical evaluation of whether the accounting profession should play a role in combating modern-day slavery. *AND* Demonstrates sophisticated abstraction and integration of the resource material. *AND* Demonstrates a high degree of critical thinking and analysis, with candidates outlining arguments whether the accounting profession should play a role in combating modern-day slavery. *AND* Demonstrates independent reflection and extrapolation relevant to the evaluation of the resource material. *AND* Provides evidence of convincing communication. Answers are planned, succinct, and clearly articulated. (For 7, not to the same level as above.)
Scholarship	**5, 6**	Draws on the resource material and produces and effectively communicates an outstanding analysis that goes beyond a description of whether the accounting profession should play a role in combating modern-day slavery. *AND* Demonstrates a high level of analysis and critical thinking, but not quite the depth of analysis necessary to reach the level required for Outstanding Scholarship. *AND* Incorporates a competent level of integration and synthesis of the resource material. *AND* The discussion and evaluation are clear, logically developed, and precise.
Below Scholarship	**3, 4**	Produces a sound analysis of whether the accounting profession should play a role in combating modern-day slavery. *AND* Produces a clear but unsupported discussion and evaluation. *AND* Demonstrates some level of integration and synthesis of the resource material. *AND* Demonstrates some application of the resources but is largely descriptive, with insufficient evidence of independent analysis and evaluation. *AND* Shows little evidence of planning, is very descriptive, and may merely regurgitate the material provided in the resources.

		AND Critical thinking is limited or not evident.
	2	Limited understanding of the material, not at Scholarship level.
	1	Minimal amount of relevant evidence, not at Scholarship level.
	0	Missing answer or irrelevant response.

Question TWO

Suggested solution

$$\text{Unit contribution margin} = \frac{\$972\,000}{3600} = \$270$$

$$\text{Break-even point in tonnes} = \frac{\text{Fixed costs}}{\text{Unit contribution margin}}$$

$$= \frac{\$560\,000}{\$270}$$

$$= 2\,074 \text{ tonnes}$$

The company's net profit would increase from $412 000 in 2021 to $655 000 in 2022, if the sales volume is increased to 4 500 tonnes. The revised contribution margin statement is as follows.

Otago Stone Limited

Contribution Margin Statement

For the year ended 31 December 2022

	NZ$
Sales ($2 088 000 ÷ 3600 × 4500)	2 610 000
Variable costs	
Manufacturing ($684 000 ÷ 3600 × 4500)	(855 000)
Selling ($432 000 ÷ 3600 × 4500)	(540 000)
Contribution margin	1 215 000
Fixed costs	
Manufacturing	(216 000)
Selling	(234 000)
Administration	(110 000)
Net profit	655 000

Should *Otago Stone Limited* accept the order from the overseas customer, the contribution margin statement would be as follows.

Otago Stone Limited

Contribution Margin Statement (based on overseas order)

For the year ended 31 December 2022

	NZ$
Sales (3000 × $580) + (3000 × $520)	3 300 000
Variable costs	
Manufacturing ($684 000 ÷ 3600 × 6000)	(1 140 000)
Selling ($432 000 ÷ 3600 × 6000)	(720 000)
Contribution margin	1 440 000
Fixed costs	
Manufacturing	(216 000)
Selling	(234 000)
Administration	(110 000)
Net profit	880 000

While there is an increase in profit, there is no indication of how long the overseas order will last. There are issues associated with not being able to supply existing customers. Should they accept the order, there are reputational issues to consider. Freight delays, increasing interest rates, as well as political uncertainty could potentially mean that this is a one-off order: no ability to increase production to service existing clients within resource consent constraints. Does *Otago Stone Limited* have the resources to increase production by a further 1 500 tonnes?

Break-even sales to the North Island would be calculated as follows:

North Island contribution margin = \$270 − \$80 = \$190

North Island break-even units = \$229 900 / \$190 = 1210 tonnes

Otago Stone Limited

Contribution Margin Statement (based on North Island sales)

For the year ended 31 December 2022

	NZ$
Sales (4500 × \$580) + (950 × \$580)	3 161 000
Variable costs	
Manufacturing (\$684 000 ÷ 3600 × 4500) + (\$684 000 ÷ 3600 × 950)	(1 035 500)
Selling (\$432 000 ÷ 3600 × 4500) + ([\$120 + \$80] = \$200 x 950)	(730 000)
Contribution margin	1 395 500
Fixed costs	
Manufacturing	(216 000)
Selling (\$216 000 + \$229 900)	(445 900)
Administration	(110 000)
Net profit	623 600

Natural stone is heavy and difficult to move. It is not clear that the costs associated with transport to the North Island have been fully considered in the scenario. Management is assuming that customers in the North Island will be prepared to pay a premium for transporting the natural stone. Additional production fits in with current resource consent. However, this does not leave much room for further expansion. However, the management needs to realise that they are not breaking even on this order.

Should *Otago Stone Limited* purchase a new quarrying machine for \$1 170 000, the new break-even amounts will be:

Revised contribution margin with new quarrying machine = \$270 + \$50 = \$320

Break-even units with new machine = (\$560 000 + \$117 000) ÷ \$320 per tonne = 2116 tonnes (rounded)

Break-even sales dollars with new machine = 2116 tonnes × \$580 = \$1 227 280 (rounded)

As there is negligible difference in the break-even point between current operations and the introduction of the new machine, management of *Otago Stone Limited* should consider other factors such as the impact that reductions of staff may have on the local economy. There are also reputational factors that management should consider. On the other hand, there may be a reduction in health and safety incidents.

Make a recommendation.

Judgement

Outstanding scholarship	**7, 8**	Thorough and insightful understanding of management decision-making in the context of the company *Otago Stone Limited*. AND Demonstrates the technical ability to make the correct supporting calculations, including margin of safety and incremental revenue, and use them to explain whether *Otago Stone Limited*'s management should expand sales into the North Island, purchase the new quarrying machine, or accept overseas orders. AND Shows a high degree of critical thinking, technical ability, and analysis, and convincing communication to produce a well-constructed response that clearly communicates their recommendation. (For 7, the level of communication not as developed as above.)
Scholarship	**5, 6**	Illustrates why a product's contribution margin was important for management decision-making. AND Demonstrates the technical skills necessary to support their answer with correct calculations, including margin of safety, and attempts to calculate incremental revenue and use them to explain why *Otago Stone Limited*'s management should expand sales into the North Island, purchase the new quarrying machine, or accept overseas orders. AND Thorough understanding of management decision-making in this context. Presents evidence of critical thinking and analysis in their discussion but may have had some inconsistencies within their response. (For 5, the understanding, critical thinking technical skills and decision-making not as detailed as above.)
Not achieved	**3, 4**	Explains why the contribution margin was important for *Otago Stone Limited*'s management. AND Partially correct calculations but some information misinterpreted. AND Has some understanding of management decision-making. Could not calculate the incremental revenue. AND Provides limited evidence of critical thinking (For 3, had limited understanding of management decision-making.) These candidates could generally not calculate the incremental revenue.
	2	The answer shows limited understanding relevant to the question. Some information is recalled, but ideas are not explained or analysed.
	1	The answer contains a minimal amount of relevant evidence.
	0	No response. No relevant evidence.

Question THREE

Suggested solution

- Only those items that meet the definition of liability should be included in the statement of financial position. Two questions need to be answered:
  - Do the loan and accrued interest still meet the definition of a liability?
  - Given that there have not been any warranty claims, should a provision for warranty be recognised?
- A liability is *a present obligation of the entity to transfer an economic resource as a result of past events*.
- What can we take from the definition? The three elements of the definition:
  - a liability represents a present obligation of the entity
  - it arises from past events
  - it creates an obligation to transfer economic resources away from the entity.
- At the reporting date does *Boats R Us Limited* effectively have no reasonable alternative other than to repay the loan or provide guarantee? The obligation for the warranty currently exists and is not contingent upon some future event. A liability exists when, at a given point in time, an organisation effectively has no reasonable alternative other than to settle the obligation at a future date.
- Has the event that creates the obligation occurred? The loan was received, and the interest was accrued. The sale of the boat hulls was the event that created the obligation for the warranty provision.
- For *Boats R Us Limited* to recognise a liability, there has to be an obligation to ultimately transfer something that has value. That is, it has a responsibility to give up something that constitutes 'economic benefits'. For the boats, this could be the replacement of hulls (inventory assets) or the case for repairs. The loan and interest payable is cash.
- The three elements of the definition appear to be met, so an entry should be made to recognise a liability for the provision for warranty.
- However, to recognise liabilities in the statement of financial position, your friend needs to make a judgement that the disclosure of the liabilities will provide information that is both relevant and representationally faithful to the bank.
- Two factors to consider in determining whether information disclosed by a liability is relevant are:
  - existence uncertainty
  - probability associated with the expected inflow of economic benefits.
- For *Boats R Us Limited* to recognise a liability in the financial statements, it needs to be reasonably apparent that an obligation to an external party exists. This is met for the loan, accrued interest, and the warranty provision. However, your friend is arguing that for the warranty provision level of existence uncertainty is high, there is little likelihood of a future cash outflow, so it is inappropriate to recognise a provision for warranty in the financial statements. This argument cannot be sustained as new material and technology is being used.
- Your friend is also arguing that there is a high degree of measurement uncertainty associated with the outflow of economic benefits for warranty. This means that a faithful representation of the liability is potentially not possible, so it is inappropriate to recognise the provision for warranty in the financial statements.
  - Since the recognition of liabilities relies upon professional judgements about the probability and measurability of expected future cash flows, your friend is using the potential difficulties, or uncertainties, associated with assessing probabilities and reliable measurements as an 'excuse' not to recognise a provision for warranty.
  - Including a provision for warranty in the statement of financial performance is the most appropriate action to take in this case.
- Income relates to transactions or events that cause an increase in the net assets of the reporting entity (net assets represent assets less liabilities), other than increases in net assets that arise as a result of owner contributions. The recognition of income is directly dependent upon the recognition of a change (increase) in assets and / or a change (decrease) in liabilities.
- As your mutual acquaintance has forgiven the debt (the loan and the accrued interest), this is a reduction of a liability and so should be recognised as income.
- Consider the impact on the financial statements. Profitability increases in the current year, perhaps offset by an increase in warranty expenses. Interest coverage, solvency and liquidity ratios improved.

Judgement

	Score	
Outstanding Scholarship	**7, 8**	Thorough understanding of the definition and recognition criteria for financial statement elements contained in the New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting (2018 NZ Conceptual Framework). *AND* Draws on the scenario and correctly applies the definition and recognition criteria to convincingly argue that a provision for warranty should be recognised in the financial statements at the end of the reporting period. The company should derecognise the loan as it no longer meets the recognition criteria, in particular faithful representation. *AND* Clearly uses convincing communication to convey their point of view. The answer must be succinct. (For 7, the level of communication and innovation not as developed as above).
Scholarship	**5, 6**	Thorough understanding of the definition and recognition criteria for financial statement elements contained in the New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting (2018 NZ Conceptual Framework). *AND* Draws on the scenario and correctly applies the majority of the definition and recognition criteria to convincingly argue that the provision for warranty should be recognised in the financial statements at the end of the reporting period. The company should derecognise the loan as it no longer meets the recognition criteria, in particular faithful representation. *AND* Clearly uses communication to convey their point of view. However, the answer may not be succinct. (For 5, the level of communication and innovation not as developed as above.)
Below Scholarship	**3, 4**	Some understanding of the financial statement elements contained in the New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting (2018 NZ Conceptual Framework). *AND* Draws on the scenario and correctly applies some of the definition and recognition criteria to convincingly argue that a provision for warranty should be reflected in the financial statements. May understand parts of the recognition criteria.
	2	Limited understanding of the material, not at Scholarship level.
	1	Minimal amount of relevant evidence, not at Scholarship level.
	0	Missing answer or irrelevant response.

Question Four

Suggested solution

Dr		Contributed equity	540 000	
Dr		Retained earnings	472 500	
	Cr	Bank		1 012 500
		Repurchase of 450 000 shares at $2.25 each		
Dr		Bad debts	18 200	
		Accounts receivable		18 200
		Write off debtor at reporting date		
Dr		Allowance for doubtful debts	36 850	
	Cr	Doubtful debts / Bad debts		36 850
		Reduction in allowance for doubtful debts		
Dr		Income tax expense	178 800	
	Cr	Income tax paid in advance (Provisional tax)		100 000
	Cr	Income tax payable		78 800
		Recognition of income tax expense for the year		
Dr		Depreciation	28 100	
	Cr	Accumulated depreciation		28 100
		Depreciation on plant to date of fire		
Dr		Accumulated depreciation	101 160	
	Cr	Disposal account		101 160
		Write-off of accumulated depreciation on plant destroyed		
Dr		Sales	300 000	
	Cr	Disposal account		300 000
		Reallocation of insurance proceeds		
Dr		Disposal account	449 600	
	Cr	Plant and equipment		449 600
		Write-off of cost of plant and equipment destroyed by fire		
Dr		Loss on disposal of asset	48 440	
	Cr	Disposal account		48 440
		Recognising loss on item of plant destroyed by fire		

Dr		Depreciation	80 800	
	Cr	Accumulated depreciation		80 800
		Depreciation on buildings to date of revaluation		
Dr		Accumulated depreciation	1 191 000	
	Cr	Buildings		1 191 000
		Writing off accumulated depreciation on revaluation		
Dr		Buildings	1 431 000	
	Cr	Gain on revaluation (OCI)		1 431 000
		Recognising gain on revaluation of buildings		
Dr		Gain on revaluation (OCI)	1 431 000	
	Cr	Revaluation surplus – buildings		1 431 000
		Transfer of gain from OCI to revaluation surplus		
Dr		Depreciation	42 000	
	Cr	Accumulated depreciation		42 000
		Depreciation on revalued buildings		
Dr		Depreciation	476 400	
	Cr	Accumulated depreciation		476 400
		Depreciation on plant ($3 625 600 – $449 600)		
Dr		Loss on revaluation (OCI)	1 088 300	
	Cr	Land		1 088 300
		Recognising loss on revaluation of land		
Dr		Revaluation surplus – land	1 088 300	
	Cr	Land		1 088 300
		Transfer of loss from OCI to revaluation surplus		

Journal entries are not required but are provided for completeness, as a large number of candidates complete these as part of their workings.

Coldbreeze Limited
Statement of Financial Position
At 31 August 2022

	Notes	NZ$
Non-current assets		
Property, plant, and equipment	1	16 622 060
Current assets		
Inventory	2	2 199 400
Accounts receivable (1 412 200 – 18 200 – 71 700 + 36 850)	3	1 359 150
Income tax paid in advance (Provisional tax)		21 200
Bank		603 100
		4 182 850
Total assets		20 804 910
Non-current liabilities		
Long term loan		6 191 200
Current liabilities		
Accounts payable		1 321 500
		1 321 500
Total liabilities		7 512 700
Net assets		13 292 210
Equity		
Contributed equity		6 595 200
Revaluation surplus land		2 718 500
Revaluation surplus building		1 431 000
Retained earnings		2 547 510
		13 292 210

This is not required, but is provided for completeness.

Coldbreeze Limited
Statement of movements in equity
For the year ended 31 August 2022

		Revaluation surplus			
	Contributed equity	Land	Buildings	Retained earnings	Total
	NZ$	NZ$	NZ$	NZ$	NZ$
Balance 1 September 2021	7 135 200	3 806 800	–	2 549 200	13 491 200
Total comprehensive income for the year		(1 088 300)	1 431 000	525 310	625 010
Share buy back	(540 000)			(472 500)	(1 012 500)
Distributions				(54 500)	(54 500)
Balance 31 August 2022	6 595 200	2 718 500	1 431 000	2 547 510	13 292 210

1 Property, plant, and equipment

	Land	Buildings	Plant and equipment	Total
	NZ$	NZ$	NZ$	NZ$
At 31 August 2021				
Cost or valuation	10 548 300	6 060 000	3 625 600	20 233 900
Accumulated depreciation	–	(1 110 200)	(1 868 600)	(2 978 800)
Net book value	10 548 300	4 949 800	1 757 000	17 255 100
Year ending 31 August 2022				
Opening net book value	10 548 300	4 949 800	1 757 000	17 255 100
Additions	–	–	–	–
Disposals	(–)	(–)	(348 440)	(348 440)
Revaluation surplus	(1 088 300)	1 431 000	–	342 700
Depreciation expense	–	(122 800)	(504 500)	(627 300)
Net book value	9 460 000	6 258 000	904 060	16 622 060
At 31 August 2022				
Cost or valuation	9 460 000	6 300 000	3 176 000	18 936 000
Accumulated depreciation	–	(42 000)	(2 271 940)	(2 313 940)
Net book value	9 460 000	6 258 000	904 060	16 622 060

The land was revalued on 1 May 2022 by *Spin Ditty*, an independent valuer, to fair market value based on the fair value of surrounding properties. The deficit on revaluation has been debited to the asset revaluation reserve through other comprehensive income.

If land was stated at historical cost, the amount would be $6 741 500 ($10 548 300 – $3 806 800).

If buildings were stated at historical cost, the amount would be $4 828 600 ($6 060 000 – (($1 110 200 + $121 200).

Land is mortgaged to the value of $4 860 000.

Depreciation is calculated on the straight-line basis at the following rates:

- buildings 2 percent per annum
- plant and equipment 15 percent per annum

	NZ$
2 Inventory	
Finished goods	2 199 400

3 Accounts receivable	
Accounts receivable	1 394 000
Less allowance for doubtful debts	(34 850)
	1 359 150

Judgement

	Score	
Outstanding Scholarship	**7, 8**	Exhibits the technical ability to correctly determine all the relevant financial statement figures (land and buildings at historical cost) from the scenario provided, and ensures that they correctly flow through to the statement of financial position extract. *AND* Exhibits the technical skills necessary to correctly prepare the statement of financial position extract including accompanying notes, clearly setting out workings. *AND* Provides evidence of convincing communication in that the statement of financial position extract and accompanying notes are correctly and neatly prepared, correct in all respects, and in a format suitable for external reporting purposes.
Scholarship	**5, 6**	Exhibits the technical ability to correctly determine the majority of the relevant financial statement figures (land and buildings at historical cost) from the scenario provided and ensures that the ones made flow through to the statement of financial position extract. *AND* Exhibits the technical skills necessary to correctly prepare the statement of financial position extract, including notes, clearly setting out workings. *AND* Provides evidence of convincing communication in that the statement of financial position extract and accompanying notes are prepared in a format suitable for external reporting purposes.
Below Scholarship	**3, 4**	Exhibits the technical ability to correctly determine some of the relevant financial statement extract figures from the scenario, and ensures that the ones made flow through to the statement of financial position. *AND* Exhibits some of the technical skills necessary to correctly prepare the statement of financial position extract, including note in a format suitable for external reporting purposes. *OR* Has the technical ability to calculate the adjustments but does not adjust the statement of financial position extract, set out their answer clearly and neatly, or show any workings. *AND* Fails to provide evidence of convincing communication in that they fail to set out the statement of financial position extract clearly, neatly, or use the correct terminology. Accompanying notes incomplete.
	2	Limited understanding of the material, not at Scholarship level.
	1	Minimal amount of relevant evidence, not at Scholarship level.
	0	Missing answer or irrelevant response.

Cut Scores

Scholarship	Outstanding Scholarship
17 – 23	24 – 32