National Certificate of Educational Achievement
TAUMATA MĀTAURANGA Ā-MOTU KUA TAEA

# Exemplar for Internal Achievement Standard

# Accounting Level 3

This exemplar supports assessment against:

Achievement Standard 91407

Prepare a report for an external user that interprets the annual report of a New Zealand reporting entity

An annotated exemplar is an extract of student evidence, with a commentary, to explain key aspects of the standard. It assists teachers to make assessment judgements at the grade boundaries.

New Zealand Qualifications Authority

To support internal assessment

| | Grade Boundary: Low Excellence |
|---|---|
| 1. | For Excellence, the student needs to prepare a comprehensive report for an external user that interprets the annual report of a New Zealand reporting entity.<br><br>This involves:<br><br>• providing an interpretation for an external user of the annual report of a New Zealand reporting entity in relation to its wider economic activities<br>• drawing a conclusion covering the limitations of the report and justifying the recommendation to meet the needs of an external user.<br><br>This student has prepared a report for Mereana, a potential shareholder. The context for interpretation is the 2013 annual report of Mighty River Power. Profitability, liquidity, cash management and an aspect of market analysis have been interpreted for Mereana, to an extent that is relevant to her needs.<br><br>Mereana's wishes for investing in a company with ethical practices (1) and the prospect of a long-term return (2) have been identified in the introduction and addressed in the report. There is evidence of the student having used other media material to support their reporting of Mighty River Power (3).<br><br>The student's recommendation that Mereana buy Mighty River Power shares has been justified using financial (4) and non-financial (5) reasons that relate back to her specific needs.<br><br>Limitations of the student's report have been identified (5).<br><br>For a more secure Excellence, the student could strengthen their market analysis beyond dividends and state how the 12c per share dividend in 2013 compares to previous years. The 'gross dividend yield' could be explained for Mereana who is a layperson without a deep knowledge of accounting. |

Student 1: Low Excellence

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*Introduction*

The purpose of this report is to analyse the 2013 annual report of Mighty River Power (MRP) in order to make a recommendation for Mereana regarding her potential investment of $10,000. Mereana is looking for an ethical business that will generate a significant long term return on her investment to supplement her retirement fund 1

*Brief history of Mighty River Power omitted.*

Based on the analysis that follows, my recommendation is that Mereana invest $10,000 in shares in Mighty River Power.

*Profitability*

*Several profitability paragraphs omitted. The following paragraphs typify the nature of the content.*

With the completion of the new geothermic station, Ngatamariki, it is assumed that the net profit will stabilise/increase in coming years. MRP has described it as meaning "greater earnings surety under most market conditions, including weak Waikato hydro conditions". Not only is geothermic power not susceptible to uncontrollable forces such as the weather, it also has lower operating costs. Therefore, up to 40% of power MRP generates will decrease expenses and provide continuous power generation regardless of the weather. Combined, this will sustainably decrease expenses, increasing profit in the long run. This means that Mereana's investment would be secure, but also, the higher the profit, the more dividends will be paid to shareholders and her gross dividend yield will increase. This also meets Mereana's requirement for an ethically sound business as MRP obviously has a significant long-term consideration for preserving the environment and natural resources. 2

MRP's expense percentage has increased from 2012 to 2013, from 70c of expenses per $1 of sales, to 72c of expenses per $1 of sales. This is consistent with the increase in net profit, however can be explained because of the $97.9m in sales …

If net profit was to decrease, this would reduce the amount of dividends paid to shareholders and decrease the value of Mereana's investment overall. However, as MRP provides 17% of New Zealand's electricity, it is unlikely that a drop in sales will be significant enough to seriously affect Mereana's investment. According to the annual report, the "small drop off in residential demand is consistent with the picture nationally". Profitability is important to Mereana, as that is what both her income stream (dividends) and the increasing value of her investment is dependent on. If MRP's financial position weakens significantly or long-term, then the value of her investment will not meet Mereana's purpose of supplementing her Kiwisaver. She could potentially make a loss over the intended 25 years of investment. … The only change in demand may be an increase in sales during winter (due to heating etc). This would provide relative security for Mereana's investment compared to investing in other industries. 2

*Liquidity*

*Cash Management*

*These sections, not affecting the student's grade, have been omitted from this exemplar.*

Mereana's main consideration, aside from financial, is that her chosen investment has ethical business practices. MRP could be considered ethical on the grounds that they have a great environmental concern. Most of their power is generated from hydro, secondly geothermic, with only 7% being generated from gas. In recent years, they have invested $1.4 billion in geothermal energy, which is seen as an 'investment' in sustainability. 1

While methods of fuel generation such as hydro and geothermic are considered more environmentally friendly compared to gas based generators, there are concerns regarding the land and resources used to generate this fuel. As Mereana's investment is long term, the long-term consideration for alternative geothermic energy suggests that MRP plans to remain sustainable while also being profitable, allowing Mereana to maintain/increase her income stream and investment over time.

MRP could also be considered ethical, based on the increase in the health and safety of employees. Large construction projects such as Ngatamariki, highlight the way in which the company manages the health and safety of its employees. The 17% reduction in the Total Recordable Injury Frequency Rate (TRIFR) of the most recent project, from 3.54 to 0.98, shows that MRP is being ethical in terms of making a conscious effort to enhance the health and safety of their employees. 1

MRP also plays an active role in the local community, through such means as raising $1m for Starship Children's Hospital in the past year.

MRP (and related companies) have developed a variety of programmes and services to make customer experiences as user friendly as possible, to "improve customer satisfaction and loyalty". This is done with the intention of maintaining and increasing customers and therefore revenue, to improve profits long term. These include:

- Mercury Energy's 'good energy monitor', an online service that monitors how much power the consumer uses to help reduce power consumption (environmental factors).
- Glo-Bug – an energy prepay service, "energy management, cost effective and help to be sustainable". MRP claims that consumers who use this service pay less for their power and save energy at the same time, as well as "a significant reduction in the number of disconnections …"

Both of these services are considered ethical as … *[detail omitted from this exemplar}*

*Dividends*

The final dividend for 2013 was declared at 7.2c per share, amounting to total dividends of 12c per share in 2013. ... According to NZX markets, the gross dividend yield of MRP is 7.298%, the highest rate of return out of New Zealand's main power generators - 0% for Meridian and Genesis, 6.256% for Contact Energy and 7.107% for Trust Power. (3)
For her $10,000 Mereana could purchase 4,237 shares ($2.360 as at 28.7.14), therefore she would have received a total of $508.44 of dividends in 2013. In order to be able to declare dividends, MRP must pass a solvency test ... MRP has obviously passed both tests in order to be able to issue shares, especially of a value of $168 million. The test is conducted in order to ensure that companies have the ability to repay their debts and have a stable financial position. As MRP issues dividends, this highlights their stability as a going concern, and therefore the stability of Mereana's potential investment, while suggesting an ongoing annual return.

*Conclusion*

Based on MRP's 2013 financial year, it would appear that they have a strong financial position and cash management. Enough so for Mereana to be confident enough that they will remain profitable and liquid, securing and increasing the value of her investment and income stream in the long run. While it is not crucial to her, the dividends that she will receive in the short run may aid Mereana in terms of day-to-day expenses, or provide her with a little bit extra to treat herself or her family. (4)

As a result of recent political interference through asset sales in New Zealand, investors are being cautious. There is low demand, especially for power generating companies, therefore the share price is relatively low. Once the uncertainty has settled, the share market and value should stabilise/increase. In the case of MRP, they have identified this issue and taken relevant measures, such as the share buyback scheme, to ensure the loyalty and value of shareholders' investments. (5)

Genesis Energy is due to go on the market soon at a relatively low price of $1.55, which is another potential option for Mereana. However, Genesis Energy is nowhere near as environmentally friendly (ethical) as MRP as their main production comes from gas/coal generation from Huntly Power Station. (3)

MRP has recently undergone a share 'buyback' scheme in which the company will repurchase $50m worth of shares. This is a common practice used by companies in the past to increase the share price and therefore benefit shareholders. The trading price of MRP shares has fallen from their initial selling price of $2.50 at their issue in 2013, therefore this is a way of potentially appeasing shareholders, by increasing the value of their shares, to maintain investors. This is good for Mereana, as if she were to purchase shares at the current market value ($2.360 as at 28.7.14) the value of her investment would increase as a result of the buyback scheme. (4)

Mereana should invest her $10,000 in Mighty River Power shares as they provide a relatively secure investment in an industry that will not be negatively affected by consumer demand (electricity is an ongoing and increasing necessity). MRP also satisfies Mereana's non-financial requirement for a potential investment as they are ethical by being environmentally and morally sound. Their long-term consideration is not only for the financial position of their business, but for New Zealand's resources and environment. (5)

MRP is in a strong financial position, and although it is not her primary purpose in investing, will generate Mereana an annual return through dividends. Although nobody can predict the future, it is likely that Mereana's investment will increase in the long run, through initiatives such as the long-term investment in geothermic power generation. This capital gain on the value of her shares suits her purpose of receiving a long-term return to supplement her retirement in 25 years. (4)

*Limitations*

A limitation of the report I have prepared for Mereana is that the annual report was published in October 2013 and covered the year ended 30 June, therefore the information is slightly out-of-date. More current information would provide more accurate findings and more certainty around economic forecasts. I would also caution Mereana that I am a student of Level 3 NCEA Accounting rather than a qualified accountant, therefore my interpretation of the MRP annual report and other information about the company may not be as sophisticated as it could be if I were more qualified. (5)

*All sources cited and a bibliography provided.*

| | Grade Boundary: High Merit |
|---|---|
| 2. | For Merit, the student needs to prepare an in-depth report for an external user that interprets the annual report of a New Zealand reporting entity.<br><br>This involves:<br><br>• providing an interpretation for an external user of the annual report of a New Zealand reporting entity linked to other financial and non-financial information contained in the annual report<br>• drawing a conclusion including reasons for the recommendation to meet the needs of an external user.<br><br>This student has prepared a report for Josh Potts, a potential employee who is seeking a software developer position that will offer him the prospect of wage growth. The context for interpretation is the 2012 annual report of Xero Ltd. Profitability, liquidity, cash management and employment issues have been interpreted to meet Josh's specific needs.<br><br>In their interpretation the student has made links (1) between contents of the annual report and other financial (2) and non-financial (3) information. The student has also responded to Josh's concern about the prospects for improving his income in the position (4). Reasons have been provided for the recommendation that Josh seek a position at Xero (5).<br><br>For a more secure Merit, the student could strengthen their interpretations of financial outcomes and analysis measures. This 'unpacking' would enable Josh, a layperson, to gain a better insight into Xero's performance for the accounting period. |

**Student 2: High Merit**

NZQA Intended for teacher use only

*Executive Summary*

The following report has been prepared for Josh Potts who has been offered employment as a software developer at Xero Limited. The aim is to provide an in-depth analysis of the situation of Xero Limited using their annual report for the year ended 31 March 2012 and provide a recommendation to Josh Potts on whether he should accept the job. Josh has also requested information on the likelihood of wage growth in the near future.

Xero Limited is an online accounting software company founded in 2006 by Rod Drury that prides itself in its 'beautiful' and easy to use software. Xero Limited operates on the cloud which means the data can be accessed from any kind of internet access - including the user's laptop at home, work and smartphone. Xero is used by small business owners and their accountants as an accounting system to perform tasks such as sending invoices, tracking inventory and carrying-out pay runs.

The company presently has operations in the UK, US, Australia and New Zealand and are currently undergoing large global expansions, opening new offices in these overseas markets and employing a diverse range of staff for operations. While Xero is an exciting New Zealand company leading online accounting, the large costs of initial investment and a customer base that is still emerging mean that the company has yet to make a profit. On the basis of this report, I recommend that Mr Potts accepts the job, but he should not expect wage growth in the near future.

*Profitability*

Despite figures showing that Xero Limited has made a loss of nearly $8 million dollars, the company achieved "outstanding growth" for the year ended 31 March 2012 according to Chairman Sam Knowles. Xero Limited has doubled their revenue from $9.3 million to $19.3 million and customer numbers are trended upward from 36,000 for the year ended 2011 to 78,000 in 2012. 2

Knowles acknowledges that Xero are "executing a growth strategy to become a global leader in online accounting." This strategy involves the execution of scaling internationally in three major markets of the UK, the US and Australia.

The Cash Flow Statement shows that Xero raised capital funds during the 2012 year through private offerings which raised over $20 million and created a Share Purchase Plan which provided over $15 million in capital. This Share Purchase Plan (SPP) allowed major NZ shareholders to invest further in Xero. This confirms that Xero's shareholders have faith in the company's expansions and are not put off by Xero's losses as it continues to grow. This should encourage Josh Potts to take the job because current investors with an interest in Xero Limited believe that this company has the potential to grow. With the confidence of investors and those involved in the online software industry, it is more likely that Josh Potts' job will be secure at Xero Limited. 1

Xero currently has high operating expenses as shown by the huge increase in expenses from the 2011 year, which were up nearly 10 million to $28,385,000. These can be put down to the jump in employee entitlement costs of $19,272,000, management of information in the US and marketing/advertising of close to $3,000,000. 2
The employee entitlement expenses increased as Xero hired 81 new staff members and selected employees were offered employee share incentive plans.

In the report Rod Drury referred to Xero as a world leader of accounting software. Therefore Xero limited must ensure that their technology is progressive and incorporates new ideas. Over the 2011/2012 financial year, Xero integrated two acquisitions into their accounting software, Paycycle and Max Solutions Holdings Limited, which are new features to advance the software. This will make Xero's systems less impeding as they now include a payroll system/management and tax solution system which will attract more customers and thus allowing more profitability in future accounting periods. 1

Over the year Xero has continued to target small accounting businesses in the NZ and overseas markets and encouraged them to bring their clients on board. The cost of training and promotion has increased because of this, but getting these people onside has been critical in growing the customer base.

An increasing global customer base means that more staff like Josh Potts are required in offices worldwide to enable operating capability and product development. This will further advance/promote the product, attracting more customers and thus revenue. If Josh accepted the job offer he may in the future have the opportunity to work overseas for Xero, which would be very useful for his CV. 3

With revenue and customers on a steady upward trend and the net loss percentage improving from -80.15% in 2011to -41.8% in 2012, Xero are moving in the direction of profits. Additionally, revenue is rising at a greater rate than expenses so total expense percentage is improving (from 193% in 2011 to 146% in 2012). If this continues, Xero Limited is likely to at some point reach profits and Xero Limited will be able to operate into the future, meaning Josh will have secure employment with Xero. 2

High expenses coupled with focus on growth internationally are the main reasons that Xero, to date, has never made a profit. Sam Knowles forecasts that "to maintain the momentum the company must continue to invest and it is to be expected that Xero will again make a loss in the next financial year".

*Liquidity and Cash Management*

Xero is a firm with a large volume of cash in its bank. The closing bank balance for the 2012 year shows a figure of $38,976,000 in cash or cash equivalents. This is over $20 million greater than the previous year's closing bank

balance of $16,922,000 meaning that Xero has gained funds. These funds have come from the purchase of additional shares by current shareholders and will finance the growth scheme for Xero over the next few financial periods and be available for acquisitions. This funding has meant that Xero has few current liabilities and no long term liabilities as the company have not had to acquire bank loans to fund their investments.
Along with the large quantity of cash in the bank, total assets for Xero Limited of over $57 million are substantially helped by the upward trending intangible asset figure of $10,260,000 for the year ended 2012. Additions in software development to maintain the "emerging leader" position in online accounting software is the main reason for the increase in intangible assets.
*Discussion of cash flows in operating, investing and financing activities omitted from this exemplar.*
High levels of assets and very few liabilities have led to a net asset figure of $52,248,000 which accounts for the high current and liquid ratios of 6.93:1 and 6.86:1 respectively. Although cash rich, CEO Rod Drury dismisses the idea of using this money for dividend pay outs and is says "This isn't money for dividends, this is money for growth."

*Employment Analysis*
Xero Limited has a team of 194 at present, with 44 of these staff members being offshore. For the financial year ended 31 March 2012, Xero recruited 81 new team members as the company opened new offices in Canberra, Milton Keynes and San Francisco. The Australian team almost doubled in size from staff numbers of 14 to 27 due to the opening of the premises in Canberra and the trebling in Australian customer numbers to 16,000.
Xero is a company which heavily relies on its software. Therefore a large team of skilled software developers are crucial for the company to ensure it continues to keep the software advanced, which attracts customers and therefore increases revenue. Alongside a team of skilled software developers, Xero needs more staff in sales, customer support, marketing and business services - all of which will allow the business to attract and maintain customers for Xero Limited in future financial years. It is forecast that there will be many openings for innovative workers in the next couple of years as Xero plans to open an office in Los Angeles to push business in the US and continue the success in Australia with additional premises in Brisbane and Sydney.
Xero Limited is clearly a company that encourages their employees to love their work. Rod Drury is quoted as saying that a team pushing the boundaries is a key to success. A large number of software developers employed over 2012/2013 received $10,000 bonuses - $5000 at 6 months of employment and the balance after 12 months with the company. This is because Rod Drury wanted to attract the best possible human resources, after saying that Xero has to compete with Trade Me and Orion Health for software developers. These bonuses and the employee share scheme are incentives for staff to stay with the company and to do their best work.
It is of interest to Josh Potts, who has been offered a job at Xero to know whether there is potential for wage growth in the next couple of financial periods. Mr Potts should not expect wage growth in the near future - as Xero have established a share scheme for employees plus bonuses to attract new workers, it is unlikely that they will increase workers' wages on top of this, particularly as the company are still yet to make a profit. 4
However, the employee incentive plan will be attractive for Mr Potts as he may be issued shares which will allow him to own a piece in the company. It is quite possible, if Josh Potts was employed as a software developer, that he will receive one of the $10,000 bonuses. The career advancement opportunities Xero provides as well as an innovative team of like-minded thinkers should also be persuasive for Josh Potts' decision. 3

*Conclusion*
I advise that Josh Potts accepts the job at Xero Limited. Employment at Xero will be a great opportunity for Mr Potts to advance his career with a forward thinking global leader in online accounting software. Josh Potts will have the chance to interact and work with a strong and innovative team. The employee share scheme may allow Mr Potts to own a part of the Xero Limited and share in potential successes.
Josh's job is likely to be secure due to the backing of Xero by shareholder confidence and investment which has led to large funds for Xero to be able to meet their debts and expand. If revenue continues to increase at a greater rate than expenses, Xero will begin to close the gap between making a loss and breaking even and should eventually reach profits, ensuring viability for Xero Limited and security for Mr Potts' job.
I do not believe that wage growth is likely at Xero Limited in the near future. The company is highly focused on global expansion with the goal of attracting customers and increasing revenue, therefore wage increases are likely to be several years away when, and if, Xero Limited begins to make profits. Xero Limited has created incentives and benefits other than wage growth for working for the company, including the employee share scheme and bonuses. Josh Potts will benefit from these while Xero drives its growth plan.

*All sources cited and a bibliography provided.*

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|---|---|
| | Grade Boundary: Low Merit |
| 3. | For Merit, the student needs to prepare an in-depth report for an external user that interprets the annual report of a New Zealand reporting entity.<br><br>This involves:<br><br>• providing an interpretation for an external user of the annual report of a New Zealand reporting entity linked to other financial and non-financial information contained in the annual report<br>• drawing a conclusion including reasons for the recommendation to meet the needs of an external user.<br><br>This student has prepared a report for Kenny, a potential employee at The Warehouse. Profitability, liquidity and cash management results for 2013 have been interpreted for Kenny, to an extent that is relevant to his needs.<br><br>Kenny has been informed of the significance of analysis results that are related to employment and the stability of the company. Links (1) have been made between contents of the annual report and other financial (2) and non-financial (3) information.<br><br>The student has also responded to Kenny's desire to work for an ethical and environmentally-friendly business (4). Reasons have been provided for the recommendation that Kenny seek a position at The Warehouse (5).<br><br>For a more secure Merit, the student could go beyond information published by the company to seek other relevant data to support the recommendation that Kenny seek a position at The Warehouse. For example, other retailers may be equally ethical and environmentally sound, or The Warehouse's stance on the use of plastic bags or its position on packaging could have been explored by researching other media sources. |

**Student 3: Low Merit**

NZQA Intended for teacher use only

*Executive Summary*

Kenny Apa is currently studying environmental science and he is looking for a part-time job to supplement his student loan. He is considering working at The Warehouse. Kenny wants to work at a firm that practices ethical business and values the sustainability of a firm, especially in terms of environmental preservation and green technology.

This is a report to analyse the financial statements and other employment-related issues to help Kenny gain a comprehensive understanding of The Warehouse so that he can make a decision about whether or not to work at WHS.

The Warehouse Group Limited comprises core businesses of: department store (known as the red sheds, 92 stores), stationary (Warehouse Stationary, 61 stores), electrical appliances (Noel Leeming, 75 stores), and outdoor gear shop (Torpedo Seven) and several online businesses. The company is the country's biggest retailer and has a turnover of $2.2 billion in FY13. It employs over 10,000 people.

I will conclude this report with a recommendation that Kenny does apply for a part-time position at The Warehouse.

*Profitability*

The Warehouse Group has had an immense growth in revenue from $1,732.1m in 2012 to $2,239.5m in 2013, a 29.3% increase. The net profit for 2013 is $145,328,000, shown on the income statement, a remarkable increase of 64.52%. 2

The growth is mostly contributed by WHS red sheds, with sales of $1,591.1m (an increase of 4.4%), which can be validated by the comment from the Group Chief Executive Officer Mark Powell, "It was a solid result with 10 quarters of positive same store sales and the introduction of a number of leading international technology and appliance brands. Operating profit for the year went up 5.3% to $85.2m, which indicates we are starting to head in the right direction. We will continue to invest in store refits and our people in FY14."

By analysing the annual report, we see the maintenance and improvement that the WHS made to attract customers and gain sales. The WHS's major driver is as the 'house of bargains' and the 'home of essentials'. Following this fundamental outline they are focused on ensuring the product quality is fit for purpose at each of their pricing point levels in the framework of 'basic, better, best' for the customers. In terms of different ways of purchasing, multi-channels and direct customer engagement are well developed.

*Further information about profitability has been omitted from this exemplar.* 2

This year saw another five stores open to meet the steady rise of demand for WHS stock. Kenny will definitely enjoy the benefits of the expansion of shops in terms of new job creation so he will have a wider variety of job opportunities in the future. 3

*Further information about sales and factors contributing to sales has been omitted from this exemplar.*

Based on what the annual report shows of the rapid growth in sales and increase in store numbers, Kenny can be reassured that WHS is a profitable and prosperous business entity with a sustainable and bright future with more and more sales channels opening up. Therefore a job offer from WHS will be secure with little risk of being laid off through redundancy which cannot be said about all industries or retailers. It could also be relatively easy to get promotion if he gets a job at a new developed store. This is because Kenny will be furthering his education and could be considered by management to have leadership potential. Even as a part-time worker he might have the opportunity to become a team leader or, if he works there full-time, a manager. This will increase Kenny's pay rate. 1

The ratio of employee expenses against revenue decreased compared to last year, from 0.1664% to 0.1588%. But this is not because pay rates went down. During the year the WHS unveiled plans for a higher pay and training plan. "To attract more talented staff, wages will be hiked for team members who have achieved a certain level of skills-based training and work with the WHS team for over three years", according to the report. Powell said that this new policy will cause an extra cost of $2m-$2.5m in each FY14 and FY15. However, it can be balanced out by an improvement of the team management, lower team turnover and improved sales and higher productivity. The details have not been finalised, but the plan will carry out during FY14 and FY15. 2

92% of New Zealanders live within a 30 minute drive to a WHS store. Kenny will therefore have a wide range of locations to work at. There will be no need to try hard to figure out which the fastest transportation or the shortest distance is to get to his workplace. This will save him a huge amount of time spent on travel and make both his life and his work more efficient. 3

As can be seen from the income statement, the employee expenses is $355.6m which is 23.34% higher compared to the FY13 ($288.3m). So Kenny does not need to worry about wages. As a matter of fact, the longer he chooses to stay with the WHS team, the higher wage he will be able to get. There is one important part of the employee expenses called performance incentive payments of $11.3m which indicates that Kenny will be able to receive an additional incentive if he works extra hard or creates outstanding achievement. This could be very motivational for Kenny. 1

G F Evans, the Chairman of WHS, earned $160,000 for FY13. Deputy Chairman K R Smith earned fees of $115,000. There are also a lot of other high positions such as departmental managers earning great salaries working for WHS. Kenny may start as a salesperson, keep working hard and strive for innovation and improvement for the WHS and end up becoming a high level manager and earning hundreds of thousands of dollars. Although he is studying environmental science, there could be an opportunity to work within head office on the WHS Group's environmental and sustainability initiatives. 3

*Cash management and liquidity information, not affecting the student's grade has been omitted from this exemplar.* 2

*Ethics and environment*

In my opinion the WHS is a fairly ethical business group. There is a high standard for the control of sources, a strict supervision for the processing and logistics are thoroughly executed, especially the food supply. An integral part of this quality assurance is how they do business with their domestic and international suppliers. As is shown on the annual report, they have a long-held commitment to robust ethical sourcing process. A solid bond is created between the customers and the WHS team, which can be proved by the increase of 4.4% or $67.0 million in the number of sales compared to last year. Same-store growth increased 2%. With the insistence on quality, WHS has gained a massive number of loyal customers who place WHS as their first choice for purchasing. This trend will continue with the future operating which indicates that they persist with the great management and make a sustainable development in the future. Thus the company needs more employees to meet the steady increase in demand, so Kenny can benefit from the stability of the company in terms of being offered a secure job. 4

*Extract from annual report omitted from this exemplar.*

The WHS is very ethical in terms of charity work as well … *Content about charity support omitted from this exemplar.* As the WHS team declared, 'clean and green is more than a slogan for us'. When it comes to the environment, they took pride in the fact that they have underpinned their commitment to preserve the resources and keep the future development sustainable. This meets the expectations of one of Kenny's considerations well as he has a strong environmental conservation spirit and values the eco-friendly business and the sustainability of it. 4

This is shown by … *[detail omitted]*

*Recommendation*

Overall, the WHS is an excellently managed and profitable business entity with a rapid and sustainable growth. Kenny will benefit from increasing demand for employees to meet the growing number of new stores. He will probably have the option of working at a range of stores or even at head office. The Warehouse stresses the importance of innovation and new technology, as well as environmental conservation, ethical and charity work. This sits perfectly with the aspirations and values held by Kenny: supporting green technological innovation and being an ethical business. Therefore I recommend The Warehouse as an ideal workplace for Kenny. 5

*Limitation*

My main two sources of information for the report was The Warehouse Group's annual report and another report from their website, their interim report. Because these were written by The Warehouse, I had to be careful that they weren't being biased towards themselves and I had to take a neutral position when writing my report. However, I am able to trust the financial parts of their reports as they have been audited to ensure their statements represent a true and fair view.

*All sources cited and a bibliography provided.*

| | Grade Boundary: High Achieved |
|---|---|
| 4. | For Achieved, the student needs to prepare a report for an external user that interprets the annual report of a New Zealand reporting entity.<br><br>This involves:<br><br>• providing an interpretation for an external user of the annual report of a New Zealand reporting entity<br>• drawing a conclusion that makes a recommendation to meet the needs of an external user.<br><br>This student has prepared a report for Mrs Dean, a potential investor in Pumpkin Patch (1).<br><br>Extensive generic descriptions of financial results have been provided in an attempt to unpack the profitability, liquidity, cash management and market analysis aspects of the company's 2011 annual report. While these descriptions largely restate sections of the report, they are linked to Mrs Dean's interest in Pumpkin Patch (2). The student had drawn a conclusion that makes a recommendation to Mrs Dean (3).<br><br>To reach Merit, the student could isolate a strong reason for the reccomendation that they make to Mrs Dean about investing in Pumpkin Patch, rather than restating interpretation sections in the conclusion.<br><br>The student's interpretations could be more relevant and succinct to meet Mrs Dean's needs as a layperson without a deep knowledge of accounting. For example, if reference is made to EBIT, interest cover and equity ratio, their purpose and significance should be explained. |

**Student 4: High Achieved**

NZQA Intended for teacher use only

*Executive Summary*
I am preparing this report for my neighbour Mrs Dean who is considering buying PPL shares. 1
PPL is determined to keep their position as the leading children's wear brand in Australasia, using four different brands PPL, Charlie & Me, Urban Angel Girls and Patch Maternity to sell their products and is increasingly recognized as an international brand.
The company has had an unsuccessful 2011 financial year due to the global economic downturn. A new CEO, Neil Cowie, has replaced Maurice Prendergast who has been the CEO for the last 18 years. Neil Cowie's leadership may be able to bring in new ideas or strategies that help the company move forward as the results from 2011 are disappointing to current shareholders and will be disappointing if you are looking for a short term return.
In the report below I will try to strongly discourage Mrs Dean from investing in PPL and look at other options such as a term investment with a bank or other companies that are in a better way financially and have a good future prospect.

*Profitability*
The 2011 financial year was another tough year for PPL as natural disasters hit Christchurch and Queensland (Australia) closing stores and resulting is customers becoming careful as to their spending practices. A high $NZ exchange rate meant that returns from overseas converted into less $NZ than when the exchange rate was lower. The political instability in the Middle East, which is where wholesale markets are based, and continued low consumption in NZ, UK, US and Ireland due to economic uncertainty caused a decrease in net profit after tax of 107.4% from $25.5m in 2010 to -$1.8m in 2011.
Added to this, expenses increased (selling expenses went up by 4.5%, administration and general expenses went up by 0.7% and the finance expense went up by 0.47%) which also negatively impacted on the net profit in a negative way. An increase in production costs, due to the cotton prices going up, affected the gross profit of the company in all sectors, and as margins decreased. Sales turnover did not increase to compensate for these costs. The breakdown of revenue from sales for 2011 was: the Australian market – 51% followed by NZ – 15%, Wholesale/Direct – 15%, UK – 14% and US – 5%. Even though total sales declined by 6.6%, 23 new stores of which 11 were Charlie & Me, were set up internationally. The set up cost, such as furniture and fittings and inventory etc, would have had a negative impact on the net profit for 2011. The Charlie & Me results are pleasing to the PPL team and this brand looks to provide vast potential for this company in the coming years which will be good for Mrs Dean if she decides to invest in the company. 2
The decision to close underperforming stores in the US and UK was necessary as the economic conditions in those markets were not generating enough growth. They have for a number of years caused repetitive and substantial losses for PPL and its share value. The poor economic conditions were also not helped by a strong NZ dollar which resulted in losses in $NZD terms from the US market, even though the sales turnover in that region was positive. Closures may also help reduce the decrease in overall earnings but will not necessarily decrease total sales as online sales are continually rising and they have strong wholesale relationships in both markets therefore PPL products will continue to be sold into these countries. PPL plan to enter into these new wholesale markets as stated above during the latter part on 2012 and 2013. They have recognised the closure costs involved on closing the US and UK stores during the first half of the 2012 year and this has recognised on the 2011 year's profitability results.
The overall turnover of PPL was negative during the 2011 financial year. In the future (from the CEO's report) sales are expected to increase as segments that are not contributing to PPL are closing. PPL predicts that there will be an increase in online and wholesale sales and yield higher profits. Again, this will be to Mrs Dean's benefit. 2

*Liquidity and Cash Management sections have been omitted from this exemplar.*
*Financial Stability*
During the 2011 financial year PPL's equity ratio has declined from 0.45:1 in 2010 to 0.16:1 in 2011. The decrease in the equity ratio was due, in the main, to a large increase in borrowing (approximately $38m). The gearing ratio trend (1.2:1 in 2010 to 5.32:1 in 2011), which is linked to equity ratio also reinforces the effect of external borrowing to cover the loss for the period mainly due to the dividend payments at the end of 2010 and during 2011.
There has been no public share issue during 2011 however as part of an employee share issue scheme 971,609 shares were issued to employees. During the year there was an interim dividend of 3 cents/share for the 2011 period and a final dividend of 5 cents/share for the 2010 period paid to shareholders. To be able to accomplish this final dividend payment for 2010 PPL must have passed the solvency test which means they were able to pay their immediate debts and liabilities as they fall due after the payment of dividends was completed. Total non-current assets have increased by $12.5m mainly due to an increase in deferred tax assets but as PPL didn't invest much money into stores and equipment the property, plant and equipment figure only increased by $1m. As equity has not increased and total assets have only slightly improved this has brought about a decrease in the equity ratio. This shows that in the future PPL may find it hard to pay back external creditors such as banks because sales have decreased and loans have increased during the 2011 financial year. This should be of concern to Mrs Dean. 2
Interest cover has fallen from 16.9 times in 2010 to 6.1 times in 2011. This ratio gives guidance as to how well PPL is placed to service the interest payment on its outstanding debt. With the decrease in operating profits (EBIT before

tax) and increased debt position, it's not surprising that this is the result. Profits from sales, and this means that operating profit covers the interest 6.1 times.
During the 2011 financial year PPL's financial stability declined. This is not a good look for the future of PPL as it could discourage potential investors from buying PPL shares. This is something Mrs Dean should be aware of. 2

*The Market Analysis section has been omitted from this exemplar.*

*Conclusion*
When reflecting over my report and the calculations and analysis that are included, PPL has had a tough year which showed up in the financial statements and therefore shows a volatile future for PPL.
The profitability of PPL is showing a negative trend because of the drop in sales and profits, these were mainly seen in the US and UK markets as they have had a significantly bad year compared to other markets such as Australia and Wholesale and Direct.
The global economic recession along with the high NZD had a large impact on the negative profits overall. The chief cause for the expenditure during 2011 was the setting up of new stores which are expected to create more sales in the future, therefore help it become more profitable. The decision to close to the US and UK stores has decreased sales in the short term but will also assist PPL in becoming more profitable and will also give them more time to focus on markets such as online sales, that are potentially more profitable and beneficial for the company in future.
The setting up of 23 new stores, mostly in the Australasian area, is expected to impact on sales in a positive way in the future, although the cost of purchasing furniture and fittings was one of the factors that placed them into a net loss position for the first half of the 2012 financial year. Online sales have increased by over 50% along with wholesale/ franchise sales going up over 32% which will increase shareholders confidence as the online market has huge potential for PPL.
The financial stability of PPL has declined which was virtually entirely due to the large increase in borrowings. The fact that no 2011 final dividend or 2012 interim dividend was paid also shows the instability of PPL and as borrowings have only gone down by $1m there is a low chance of PPL paying a dividend in the near future.
The net cash position of PPL looks positive but in fact the company has ended up with a huge bank debt which was used to cover the outflow of operating activities, investing activities and the cost of dividends paid out during the 2011 financial period.
The fall in the earnings per share during 2011 has changed and is showing a positive trend but is still significantly lower than other companies but shows the demand increasing slower. Overall, despite PPL remaining the leading children's wear brand across Australasia, the position the PPL currently hold in the market has deteriorated over the past year because of the decreasing net profit which has caused the company to borrow funds and discontinue making dividend payments over 6-12 months. Therefore I would advise my neighbour Mrs Dean not to invest in PPL. 3

*All sources cited and a bibliography provided.*

| | Grade Boundary: Low Achieved |
|---|---|
| 5. | For Achieved, the student needs to prepare a report for an external user that interprets the annual report of a New Zealand reporting entity.<br><br>This involves:<br><br>• providing an interpretation for an external user of the annual report of a New Zealand reporting entity<br>• drawing a conclusion that makes a recommendation to meet the needs of an external user.<br><br>This student has prepared a report for Mi-Cha, a potential investor in The Warehouse (1).<br><br>Explanations have been provided to help Mi-Cha understand profitability, liquidity, stability and market analysis aspects of the company's 2013 annual report. These explanations unpack relevant areas of performance and are sufficiently straightforward for a layperson (2). A recommendation has been made for Mi-Cha (3).<br><br>For a more secure Achieved, the student could more accurately explain the significance of working capital ratio, and use accurate classifications of inflows and outflows in the Cash Flow Statement. Explanations could be more explicitly linked to Mi-Cha throughout the report to assure her that the report has been written to address her specific needs. |

**Student 5: Low Achieved**

Intended for teacher use only

*Executive Summary*

This report is prepared for Mi-Cha who is thinking about investing $10,000 shares in The Warehouse Group (WHS). This report is based on the 2013 annual report. (1)

Mi-Cha wants a long-term investment as she does not plan to retire for another 25 years and the main purpose of the investment is to have a significant amount of money for when she retires, to accompany her Kiwisaver fund. This report will give Mi-Cha an interpretation of WHS's annual report and look into the viability of investing long term in the company.

For the reason I give in my report below, I will be recommending that Mi-Cha buy $10,000 worth of shares in The Warehouse Group.

*Profitability*

The Warehouse Group is made of four businesses: The Warehouse, Warehouse Stationery and two new additions in 2013, Noel Leeming and Torpedo7. These new stores have already had a positive effect on profitability. The Warehouse, which is the core of the Group, is a retail store known as "the house of bargains" and "home of essentials". They sell everything from clothing to furniture to outdoor equipment and the main market for The Warehouse is New Zealand. The Warehouse is not only increasing the number of stores it has but is also refitting older stores to make them appealing to customers and also make them profitable.

Revenue has increased from 2012 to 2013. The Warehouse reported a revenue of $2.24 billion compared to 2012 when the revenue was $1.73 billion, a 29.3% improvement. The rise of the revenue can be attributed to one of The Warehouse's main goals which is "focusing on delivering great products at the right price". This is because they have increased the amount of stock in their stores and have now added big name brands such as Sony, Acer and Kambrook. The Warehouse also stated that the improved quality of their merchandise has resulted in a lower return rate of products from 20% to 5%. Also, another important focus for The Warehouse is online sales which have risen over the past couple of years. The company estimates that online sales will triple in the next five years. The Warehouse has also launched a new website called Red Alert which is a daily deals site.

Another important factor that would have had an effect on the revenue is the mark-up percentage. In 2012 the company added an average of 36 cents to each $1 of cost price. In 2013 the mark-up decreased to 34 cents. In my opinion The Warehouse's main customer targets are the lower to middle socio-economic group of people so in order to keep sales high, they must get their pricing right. (2)

All of these factors have contributed to the rise of revenue in 2013.

Some of the major expenses WHS Group faces are employee wages, rents and occupancy, and other operating expenses. Although these expenses affected profit, The Warehouse believes that all the expenses are helping the company head in the right direction and in doing so will help profitability in the future.

We can see this in the first major expense, staff wages, which increased from $288.33 million in 2012 to $355.63 million in 2013. Some wages will probably have been put up but also the company sent most of their customer service staff on 'love your customer' courses. That is why staff expenses increased.

The lease and occupancy costs also increased by … *[detail omitted from this exemplar]*

*Cash management and liquidity*

WHS Group stated that their opening cash position was $16.29 million and finished the year at $22.76 million, a big increase that shows that WHS has managed their cash well. Buying Noel Leeming and Torpedo7 will have had a big effect on the cash increasing throughout the year. I wanted to make sure this improvement in cash was not coming from a massive loan, so I looked at the borrowing and interest rate to see if the loan had risen … *[some detail omitted from this* (2)

*exemplar]* Although the borrowing was raised, it did not change the fact that more cash was coming into the business through customers.
I then looked at the working capital ratio to see if WHS Group can pay their debts for the next accounting period. In 2012 the ratio was 1.42:1 and in 2013 it was 1.40:1. This drop can be explained by the Group using cash to invest in their expansion. However the drop is something that you would not want repeated in the following year as it could mean that The Warehouse cannot pay its immediate debts.
*The student has briefly discussed cash flows from operating, financing and investing activities. Reference has been made in the operating activities section to the payment of dividends, and loan repayment was erroneously referred to in the investing activities section.*

*Market analysis*
WHS has paid dividends on ordinary shares to shareholders since 1994 so they have a very good history of loyalty to shareholders. The dividend for 2013 was announced at 5.5 cents per share, a drop of one cent from 2012. However, this should not concern shareholders as retained earnings increased from $76.43 million in 2012 to $153.23 million in 2013, an increase of $76.79 million. The WHS Group wanted a larger retained earnings so it chose not to pay out as much in dividends. So shareholders and those like Mi-Cha looking to invest shouldn't worry because the reduction in dividends planned as an investment in the future. 2
In May the share price reached a high of $4.39 per share showing there is a lot of confidence in the company and meaning shareholders believe the company is on the right track and making wise moves in the market.
The Warehouse Group is the biggest operating retailer in New Zealand which is also reflected in its share price. This tells us that in the New Zealand market WHS is going very strong compared to its opposition and is continuing to grow. This is rather pleasing for shareholders because gaining more of the New Zealand market will lead to more dividends. 2

*Conclusion*
I would advise Mi-Cha to invest long term in The Warehouse Group. The company keeps expanding in a small and well planned out way to increase future profits. Mi-Cha has the time to wait out the expansion because she does not intend to retire for 25 years. 3

*All sources cited and a bibliography provided.*

| | Grade Boundary: High Not Achieved |
|---|---|
| 6. | For Achieved, the student needs to prepare a report for an external user that interprets the annual report of a New Zealand reporting entity.<br><br>This involves:<br><br>• providing an interpretation for an external user of the annual report of a New Zealand reporting entity<br>• drawing a conclusion that makes a recommendation to meet the needs of an external user.<br><br>This student has prepared a report for the union representing workers at Pumpkin Patch to ascertain the likelihood of achieving a 4% pay increase (1).<br><br>Various profitability, liquidity and stability analysis measures have been explained using both financial and non-financial information. While these interpret aspects of the company's performance, there is minimal material that is linked to the union's decision (2).<br><br>To reach Achieved, the student could make a recommendation for the end user, the union, regarding the wisdom of seeking a 4% pay increase. The student could place a greater emphasis on employment-related issues, and ensure that all interpretations, such as the equity ratio result, are at curriculum level 8. |

| Student 6: High Not Achieved |
|---|
| NZQA Intended for teacher use only |

*Executive Summary*

This report is prepared for the union representing workers at Pumpkin Patch Ltd to investigate and interpret the annual report, to get an understanding of whether PPL is in a position to pay workers a 4% pay increase. I have prepared this report for the purpose of analysing and interpreting the financial position, stability and employment outlook for our workers, market confidence, and performance of Pumpkin Patch Ltd 1
Background: Pumpkin Patch Ltd is a specialist clothing and accessories company who specialise in toddlers, babies, maternity, and children clothes. Australia and New Zealand are Pumpkin Patch's major markets with "wholesale and direct" markets in Asia and other countries around the world. Pumpkin Patch Ltd has just recently closed their USA stores and is in the process of closing their UK stores.

*Profitability*

While the trading conditions have remained very difficult throughout the year, Pumpkin Patch Ltd has developed strategies that will bring long term benefits to shareholders. Initiatives being developed and employed in the US and the UK will help ease the effect underachieving stores have on the overall group earnings.
In Australia Pumpkin Patch's EBIT has decreased by 25.8% to $28.708m in 2011. This is a result of the increase in fixed overheads (e.g. wages and salaries) and sales dropping by 9%.
The Queensland floods would have made a big impact on this as well as a subdued economic environment. As people were being careful with their cash, they spent less in higher-end stores like Pumpkin Patch Ltd. As sales have brought in $12.955 million in the first half of 2012 (which is $1.916m less than the six months ended 31 January 2011), Pumpkin Patch Ltd is expecting trading conditions to stay difficult even though 13 new stores were opened during the year and three more are expected to open in 2012.
In New Zealand Pumpkin Patch Ltd has experienced a decrease in turnover of $4.741m with a decrease in EBIT of $2.798m.
Sales would have been impacted by the subdued economic environment and the Christchurch earthquakes which affected the EBIT. Seven new stores were opened so some of the losses could be attributable to the capital cost of this. Even though trading conditions stabilised towards the end of the year they are expected to remain subdued.
Although the US retail sector was very challenging, total USD sales were up on last year by 4.9%. All owned and operated stores in US will be closing in the 2012 financial year due to years of not making profits. Although the stores are closing the brand will continue to be sold through wholesale partners and the growing online operation and Pumpkin Patch Ltd is exploring new opportunities for the distribution of the brand throughout the US.
The United Kingdom has suffered challenging retail conditions throughout the year and especially in the last part of the year when the financial situation rapidly deteriorated across the whole of Europe.
Although the GBP turnover has increased by 2.7%, the EBIT loss has nearly doubled. This is due to the higher exchange rate and softer sales performance. General retail conditions in the UK are expected to remain challenging so Pumpkin Patch Ltd is planning to close their UK stores in 2012. This should increase the overall 2013 profit dramatically as the other stores wouldn't have to carry UK's continual losses. Pumpkin Patch Ltd will continue to wholesale its products to other retailers and market their online Charlie and Me and Pumpkin Patch Ltd brands.
Wholesale sales continued to be impacted by high NZD exchange rates which caused wholesale partners to manage challenging retail conditions and, translated to NZDs. Direct business went a lot better than wholesale sales in 2010 and 2011 with significant increases, and with Pumpkin Patch's website being amongst the most visited children's product related websites in Australia. The company is anticipating continued growth of the Pumpkin Patch Ltd and Charlie and Me online businesses in 2012.

*Liquidity and Cash Management*

In 2010 Pumpkin Patch Ltd had a current ratio of 1.42:1 which decreased to 1.28:1 in 2011. This was largely due to the current liabilities increasing by $18.655 million due to a significant increase in Derivative Financial Instruments (DFI). DFIs are a result of Pumpkin Patch Ltd entering into a Foreign Currency Exchange contract. DFIs do not affect cash flows as they are a non-cash book entry but as a result, DFIs limit the accuracy of the current ratio by making it look a lot worse than it actually is as it is implied that it is in an acceptable cash position when it actually isn't.
Inventory represents a substantial proportion of Pumpkin Patch Ltd.'s current assets and unless they can turn this into cash they are in trouble because even though the current ratio implies that Pumpkin Patch Ltd is in a tolerable cash situation we know that this is far from the truth as in the 2011 cash flow statement we see that there was $20.929 million decrease in cash from customers while there is a $4.574m outflow from operating activities. This inadequate cash flow means that Pumpkin Patch Ltd could not qualify for the solvency test. As a result of this, Pumpkin Patch Ltd was unable to pay as much for directors' fees or for an increase in pay for all its workers. 2

*Financial Stability and Employment Issues*

The Equity ratio has fallen from 0.45:1 in 2010 to 0.16:1 in 2011 which means that the Pumpkin Patch Ltd shareholders have financed less than half of the total assets compared to external finance from outsiders e.g. creditors and finance lenders. This is bad as it is now far below the acceptable amount of 50% of total assets and it means that Pumpkin Patch Ltd is financing a significant amount of its funds on paying interest. This means they have five times as much debt as what they have equity. This means that they do have very little funding to pay for any pay rises. 2

*Conclusion*

We should complete further interpretation and analysis to decide on a 4% wage claim as PPL is not making any money and it isn't paying out dividends and even though Pumpkin Patch Ltd has closed its US and UK stores to bolster up the performing stores' profits the worldwide financial situation is very much at risk of collapse and if Europe went under the whole world would go under and people who are investing would lose it all.

*All sources cited and a bibliography provided.*