Government of **Western Australia**
School Curriculum and Standards Authority

ACCOUNTING AND FINANCE

WACE ATAR course examination 2017

Marking Key

Marking keys are an explicit statement about what the examining panel expect of candidates when they respond to particular examination items. They help ensure a consistent interpretation of the criteria that guide the awarding of marks.

2017/69843

Section One: Multiple-choice **15% (15 Marks)**

Question	Answer
1	a
2	c
3	d
4	b
5	d
6	c
7	b
8	c
9	a
10	b
11	d
12	c
13	d
14	b
15	a

GENERAL NOTES

Consequential errors should not be penalised.
Marks should not be subtracted for incorrect solutions.

Section Two: Short answer **70% (135 Marks)**

Question 16 **(22 marks)**

(a) (i) Explain how management might use cost-volume-profit analysis for decision-making purposes. (3 marks)

Description	Marks
Explains how CVP might be used for decision making	3
Provides a limited explanation about how CVP might be used for decision making	2
States a relevant fact about CVP	1
Total	**3**
Answers could include: Cost-volume-profit (CVP) analysis enables decision-makers to assess how changes in selling prices, costs and volume impact upon the performance of a business. Uses of CVP analysis for decision-making include: • identification of the break-even point where the selling and variable costs per unit sold, product mix in a multi-product business and total fixed costs are known. The budgeted break-even point establishes the minimum number of sales required to neither make a profit nor a loss (i.e. net result = zero) and can reveal what margin of safety the business has with budgeted sales being above the break-even point • where budgeted profits are unlikely to be achieved, management is able to identify how, within the relevant range of activity, changes in selling prices and/or variable costs per unit, product mix and/or total fixed costs can be made to achieve a target profit • by revealing how profits are impacted by changes in selling prices and/or variable costs per unit, product mix and/or total fixed costs, management is able to analyse and identify which particular combination of these variables provides the optimal financial outcome for the business • facilitates the making of special decisions such as make or buy, accept a special order, close-down a product line or department. For example, if a business unit or department appears to be unprofitable and management believes that it ought to be closed, CVP analysis can be used to calculate the financial impact of a decision to shut down that business unit or department • where a constraint exists (e.g. resource inputs such as direct materials or direct labour) or manufacturing capacity (e.g. machine hours), management of a multi-product business is able to determine the optimal production mix decision for maximising business profits.	
Accept any other reasonable answer.	

Question 16 (continued)

(a) (ii) Explain what is meant by the term ‘margin of safety’. (2 marks)

Description	Marks
Explains margin of safety	2
States a fact about margin of safety	1
Total	**2**
Answers could include: The margin of safety is the excess sales (measured in terms of units sold, sales revenue dollars or percentage), that the budgeted sales exceed break-even sales. For example, GreenMatt with an average monthly installation of 5000 square metres and a budgeted break-even point of 3000 square metres per month, the company would have a margin of safety of 2000 square metres.	
Accept any other reasonable answer.	

(b) Calculate the contribution margin per installed square metre. (4 marks)

Workings	Marks
CM = SP – VC	1–4
CM = 110**(1)** – (20**(1)** + 30**(1)** + 35**(1)**)	
CM = $25	
Total	**4**

Alternate workings

Workings			Marks
Selling price per installed square metre		$110	1
Less variable costs per installed square metre			
Direct material cost	($20)		1
Direct labour cost	($30)		1
Other variable expenses	($35)	($85)	1
CM		$25	
		Total	**4**

(c) Calculate the total fixed costs per month. (2 marks)

Workings		Marks
Break-even point (in units)	= $\frac{\text{TFC}}{\text{CM per unit}}$	1–2
3,000**(1)**	= $\frac{\text{TFC}}{25\textbf{(1)}}$	
$75,000	= TFC	
	Total	**2**

Alternate workings

Workings	Marks
Profit = (SP X QS) – [(VC X QS) + TFC]	1–2
At break-even, profit - zero:	
0 = (110 X 3,000) – (85 X 3,000) - TFC	
TFC = (110 X 3,000) **(1)** – (85 X 3,000) **(1)**	
TFC = 330,000 – 225,000	
TFC = $75,000	
Total	**2**

(d) (i) How many square metres of synthetic grass would have to be installed by GreenMatt to achieve the required target profit of $40,000 for December 2017? (3 marks)

Workings			Marks
Forecast target revenue (in units)	=	$\frac{\text{TFC + Target Profit}}{\text{Contribution margin per unit}}$	1–3
	=	$\frac{75{,}000\textbf{(1)} + 40{,}000\textbf{(1)}}{25\textbf{(1)}}$	
	=	4600 square metres	
		Total	**3**

Alternate workings

Workings		Marks
Profit	= (SP X QS) – [(VC X QS) + TFC]	1–3
40,000	= (110 x QS) – (85 x QS) – 75,000	
40,000 **(1)**	= 25QS **(1)** – 75,000 **(1)**	
115,000	= 25 QS	
4600	= QS	
	Total	**3**

Question 16 (continued)

(ii) Calculate the budget profit for the month ending 31 December 2017, on the master budget's basis of achieving the average installation for the month. (3 marks)

Workings	Marks
Profit = (SP X QS) – [(VC X QS) + TFC]	1–3
Profit = (110 x 5000) **(1)** – (85 x 5000) **(1)** – 75,000**(1)**	
Profit = 550,000 – 425,000 – 75,000	
Profit = $50,000	
Total	**3**

(e) What was the amount GreenMatt's total direct labour rate variance for December 2017? (5 marks)

Workings:		**Marks**
Actual direct labour cost per direct labour hour worked:		
140,000**(1)** / 4000**(1)** = $35		1–2
Direct labour rate variance	= (AR – SR) x ADLH	1–2
	= (35 – 30**(1)**) x 4000**(1)**	
	= 5 x 4000	
	= $20,000 Unfavourable**(1)**	1
	Total	**5**

Question 17 **(25 marks)**

(a) Prepare a Cash budget for the month of June 2018. (22 marks)

Workings:

Cash Sales = 40% of June sales = 40%**(1)** x 400,000**(1)** = 160,000
(i.e. 2 marks carried forward to cash budget)

Collection from credit sales

Month of sale	Calculation	Total
May – 75% of credit sales	(350,000**(1)** x 60%**(1)**) x 75%**(1)**	157,500
April – 24% of credit sales	(300,000**(1)** x 60%**(1)**) x 24%**(1)**	43,200
		200,700**(1)**

(i.e. 7 marks carried forward to cash budget)

Gain on sale of non-current asset = Proceeds – Carrying Amount
12,000**(1)** = Proceeds – 8,000**(1)**
Proceeds = 20,000
(i.e. 2 marks carried forward to cash budget)

Salaries and wages paid = salaries and wages expense + salaries and wages accrued 31/5/18
= 62,000**(1)** + 3,000**(1)**
= 65,000
(i.e. 2 marks carried forward to cash budget)

Cash paid for delivery van = 30,000**(1)**/3**(1)** = 10,000
(i.e. 2 marks carried forward to cash budget)

Insurance paid = 2,000**(1)** x 12**(1)** = 24,000
(i.e. 2 marks carried forward to cash budget)

Ayo Robotic Radio Ltd
Cash budget for the month ending 30 June 2018

	$	**Marks**
Estimated cash receipts		
Cash Sales	160,000	2
Cash collections from accounts receivable	200,700	7
Proceeds from sale of non-current asset	20,000	2
Total estimated cash receipts	380,700	
Estimated cash payments		
Cash paid to accounts payable	200,000	1
Operating expenses	13,000	1
Salaries and wages paid	65,000	2
Purchase of non-current asset: Delivery van	10,000	2
Insurance annual premium	24,000	2
Total estimated cash payments	312,000	
Budgeted cash surplus/(deficit) for month	**68,700**	
Actual cash balance at start of period	**53,300**	2
Budgeted cash balance at end of period	**122,000**	1
	Total	**22**

Deduct 1 mark for each non-relevant item included, to a maximum of 2 marks.
Deduct 1 mark for incorrect terminology, to a maximum of 1 mark.

Question 17 (continued)

(b) Identify and explain **one** purpose served by the cash budget. (3 marks)

Description	Marks
Identifies a purpose of a cash budget	1
Subtotal	**1**
Explains a purpose of a cash budget	2
Provides a limited explanation of a cash budget	1
Subtotal	**2**
Overall total	**3**

Answers could include:

The cash budget predicts future movements in cash and, therefore, the change that will occur in the cash (and cash equivalent) position during the budgeted period. Thus, the cash budgets are of great importance to ensuring the continuity of business activity and the future financial viability of the company into the foreseeable future.

The company's management will be able to use the cash budget to determine whether it has the right cash management policy in place or will need to modify it so as to avoid potential cash shortfalls or excess cash.

A cash budget may assist to:

- plan ahead and source additional short-term credit (e.g. a bank overdraft) to cover short-term cash shortfalls and be able to meet obligations as they fall due
- in combination with other budgeted financial statements (i.e. the Statement of comprehensive income and the Statement of financial position), support loan applications to be made to financial institutions
- counteract the anticipated cash shortfall by delaying discretionary (i.e. non-urgent) cash payments (e.g. advertising) and capital expenditure (e.g. new office furniture)
- for the short-term, invest excess funds in the short-term money market
- for the long-term, invest in other companies and/or purchase property, plant and equipment to accelerate the realisation of the long-term operational goals of the organisation
- evaluate business performance through comparing actual cash flows with the cash targets set for receipts and payments and the variances identified in the performance report for the period
- identify how variations in the terms and conditions negotiated with the company's suppliers (e.g. discounts received for early payment or extending the terms from say 30 days' net to 45 or 60 days' net) impact on the speed at which amounts owing in the form of accounts payable are paid
- identify how variations in the terms and conditions offered to customers who purchase on credit (e.g. discounts offered for early payment) impact on the speed at which amounts owing in the form of accounts receivable are converted to cash.

Accept any other reasonable answers.

Question 18 **(25 marks)**

(a) Calculate, showing all workings the net present value for the:

(i) Baltic Sonar Deluxe investment option. (7 marks)

Net cash flows per annum (future NCF) = cash inflows + savings in outflows – cash outflows
= 150,000**(1)** + 775,000**(1)** – 525,000**(1)**
= 400,000

PV of future NCF = NCF x PV factor
= 400,000**(1)** x 3.1699**(1)**
= 1,267,960

NPV = PV of future NCF – PV of cost of project
= 1,267,960**(1)** – 1,050,000**(1)**
= $217,960

Net present value for the Baltic Sonar Deluxe investment option: **$217,960**

Alternate workings 1:

Baltic Sonar Deluxe net cash flows	**Time 0**	**End of Yr 1**	**End of Yr 2**	**End of Yr 3**	**End of Yr 4**
Cost of acquisition	(1,050,000)				
Savings in outflows		775,000	775,000	775,000	775,000
Cash inflows		150,000	150,000	150,000	150,000
Cash outflows		(525,000)	(525,000)	(525,000)	(525,000)
Net cash flows	(1,050,000)	[400,000	400,000	400,000	400,000]**(1)**
PV factor		.9091**(1)**	.8264**(1)**	.7513**(1)**	.6830**(1)**
PV of NCF	(1,050,000)	363,640	330,560	300,520	273,200

NPV = 1,267,920**(1)** – 1,050,000**(1)**
= $217,920

Note to markers: Difference in NPV is due to rounding.

Alternate workings 2:

Calculation of net cash flows of $400,000 as per workings above **(1)**

PV of NCF $= \frac{400{,}000}{1.1\,\mathbf{(1)}} \quad \frac{400{,}000}{1.1^2\,\mathbf{(1)}} \quad \frac{400{,}000}{1.1^3\,\mathbf{(1)}} \quad \frac{400{,}000}{1.1^4\,\mathbf{(1)}}$

= 363,636 + 330,579 + 300,526 + 273,205

= 1,267,946

NPV = 1,267,946**(1)** – 1,050,000**(1)**
= $217,946

Note to markers: Difference in NPV is due to rounding.

Question 18(a) (continued)

(ii) Pacific Sonar Supreme investment option. (15 marks)

PV of cost = [960,000 + 40,000]**(1)** = 1,000,000

PV of future net cash flows

Year	cash inflows + savings in outflows – cash outflows	PVF	PV
1	150,000**(1)** + 800,000**(1)** – 400,000**(1)** = 550,000	0.9091**(1)**	500,005
2	150,000**(1)** + 750,000**(1)** – 400,000**(1)** = 500,000	0.8264**(1)**	413,200
3	150,000**(1)** + 650,000**(1)** + 50,000**(1)** – 400,000**(1)** = 450,000	0.7513**(1)**	<u>338,085</u>
			1,251,290

NPV = PV of future NCF – PV of cost of project
= [1,251,290 – 1,000,000]**(1)**
= $251,290

Net present value for the Pacific Sonar Supreme investment option: **$251,290**

Alternate workings 1:

Pacific Sonar Supreme net cash flows	**Time 0**	**End of year 1**	**End of year 2**	**End of year 3**
Cost of acquisition	($960,000)			
Installation cost	(40,000)			
Saving in outflows		150,000**(1)**	150,000**(1)**	150,000**(1)**
Cash inflows		800,000**(1)**	750,000**(1)**	650,000**(1)**
Cash outflows		(400,000)**(1)**	(400,000)**(1)**	(400,000)**(1)**
Residual value				50,000**(1)**
Net cash flows	(1,000,000)**(1)**	550,000	500,000	450,000
PV factor		0.9091**(1)**	0.8264**(1)**	0.7513**(1)**
PV of NCF	(1,000,000)	500,005	413,200	338,085

NPV = [1,251,290 – 1,000,000]**(1)**
= $251,290

Alternate workings 2:

PV of cost = [960,000 + 40,000]**(1)** = 1,000,000

Calculation for NCF as per workings above
i.e. Year 1 550,000**(3)**
Year 2 500,000**(3)**
Year 3 450,000**(4)**

PV of NCF $= \dfrac{550{,}000}{1.1\,\mathbf{(1)}} \quad \dfrac{500{,}000}{1.1^2\,\mathbf{(1)}} \quad \dfrac{450{,}000}{1.1^3\,\mathbf{(1)}}$
= 500,000 + 413,223 + 338,092
= 1,251,315

NPV = [1,251,315 – 1,000,000]**(1)**
= $251,315

Note to markers: Difference in NPV is due to rounding.

(b) Provide your investment recommendation as to which sonar instrument should be purchased stating **one** reason for your recommendation. (3 marks)

Description	Marks
Selects an investment and justifies the reason for recommendation (based on candidate's calculations)	3
Selects an investment and provides a brief reason for the recommendation (based on candidate's calculations)	2
Selects an investment (based on candidate's calculations) without stating a reason for the recommendation	1
Total	**3**
Answers could include: Recommends purchase of Pacific Sonar Supreme • this option has a greater net present value which returns $33,330 more than the alternative investment option • and does so a year earlier. Recommends purchase of Baltic Sonar Deluxe: • this option has a positive net present value • and the sonar instrument would not have to be replaced at the end of year 3 if it is required for a longer period.	

Note to markers: Do not penalise candidate for recommending neither option, if candidates calculations result in negative Net Present Value for both options. Candidate must provide an explanation.

Question 19 **(37 marks)**

(a) Prepare the General journal entry, with a narration, to record the bonus share issue made on 15 March 2017. (7 marks)

Workings:

Bonus share issue: one (1) bonus share for every ten (10) shares held:
= fully paid ordinary share capital ÷ Issued price per share.
= 600,000**(1)** ÷ 2**(1)**
= 300,000 shares

Number of bonus shares to issue:
= number of ordinary shares issued ÷ bonus share ratio
= 300,000 ÷ 10**(1)**
= 30,000 bonus shares

Value of bonus shares issued:
= Issued paid-up value x number of bonus shares issued
= 2.50 x 30,000
= $75,000**(1)**

(i.e. 4 marks for calculation of number and value of bonus share issue)

Zoopman Ltd
General journal

Date	**Particulars**	**Debit $**	**Credit $**
15 Mar 2017	Retained earnings**(1)** Ordinary share capital**(1)** Being the issue of 30 000 bonus shares fully paid to a value of $2.50 per ordinary share **(1)**	75,000	 75,000

(i.e. 3 marks for correct general journal entry based on calculation of bonus share issue)

Deduct 1 mark if no date or incorrect date provided.

(b) Prepare a Statement of comprehensive income for Zoopman Ltd for the year ended 30 June 2017. (17 marks)

Workings:

Depreciation – equipment = (cost – accumulated depreciation) x rate
= (125,000**(1)** – 5,000**(1)**) x 4%**(1)**
= 4,800

Wages and salaries = wages and salaries + accrued wages and salaries
= 254,000**(1)** + 26,000**(1)**
= 280,000

Operating expenses

Depreciation – equipment	4,800**(3)**
Bad debts expense	400**(1)**
Insurance expense	24,000**(1)**
Other expenses	119,000**(1)**
Salaries and wages	280,000**(2)**
Total operating expenses	**428,200**

(i.e. $428,200 carried forward to Statement of comprehensive income = 8 marks)

Income tax expense = profit before tax x tax rate
= 138,600**(1)** x 30%**(1)**
= 41,580
(i.e. $41,580 carried forward to Statement of comprehensive income = 2 marks)

Zoopman Ltd
Statement of comprehensive income
for the year ended 30 June 2017

	$	**Marks**
Revenue	579,800	1
Other income	2,000	1
Operating expenses	(428,200)	8
Finance costs	(15,000)	1
Profit before income tax	**138,600**	1
Income tax expense	(41,580)	2
Profit after tax for period	**97,020**	1
Other comprehensive income		
Gain on revaluation of land	25,000	1
Total comprehensive income for the period	**122,020**	1
	Total	**17**

Deduct 1 mark for each non-relevant item included, to a maximum of 2 marks.

NOTE: For 2017 only, bad debts expense can be treated as either an operating expense included in operating expenses or as an item that is included in finance costs.

Question 19 (continued)

(c) Prepare the Statement of changes in equity for Zoopman Ltd for the year ended 30 June 2017, showing the changes that occurred in all components of equity.

(13 marks)

Workings: Increase to general reserve = 60,000 – 30,000 = 30,000

Zoopman Ltd
Statement of changes in equity
for the year ended 30 June 2017

	Ordinary Share Capital $	Retained Earnings $	General Reserve $	Revaluation Reserve $	Total Equity $
Balance at beginning	600,000**(1)**	300,000 **(1)**	30,000**(1)**	0	930,000
Changes in Equity during the year					
Bonus share issue	75,000**(1)**	(75,000)**(1)**			-
Total comprehensive income		97,020 **(1)**		25,000**(1)**	122,020
Transfer to reserves		(30,000)**(1)**	30,000**(1)**		-
Balance at end	675,000**(1)**	292,020 **(1)**	60,000**(1)**	25,000**(1)**	1,052,020

Deduct 1 mark if 'Total Equity' column not shown.
Deduct 1 mark for each non-relevant item included, to a maximum of 2 marks.

Alternate narrative format of Statement of changes in equity:

Zoopman Ltd
Statement of changes in equity
for the year ended 30 June 2017

	$	**Marks**
Profit for the year	97,020	
Gain on revaluation of asset	25,000	
Total comprehensive income for the year	**122,020**	
SHARE CAPITAL		
Balance at start of year	600,000	1
Issue of share capital (Bonus issue)	75,000	1
Balance at end of year	**675,000**	1
OTHER COMPONENTS OF EQUITY		
General reserve		
Balance at start of year	30,000	1
Transfer from Retained earnings	30,000	1
Balance at end of year	**60,000**	1
Asset revaluation reserve		
Balance at the start of the year	0	
Gain on revaluation of asset	25,000	1
Balance at end of year	**25,000**	1
Total – other components of equity	**85,000**	
RETAINED EARNINGS		
Balance at start of year	300,000	1
Profit for the year	97,020	1
Transfers to General reserve	(30,000)	1
Bonus share issue	(75,000)	1
Balance at end of year	**292,020**	1
	Total	**13**

Deduct 1 mark for each non-relevant item included, to a maximum of 2 marks.
Deduct 1 mark if the components for total comprehensive income are not given (i.e. 97,020 and 25,000).

Question 20 **(26 marks)**

(a) Prepare the operating activities section of the Statement of cash flows for Galle Gold Ltd. (21 marks)

Workings:

Accounts receivable

Date	Account	$	Date	Account	$
01-07-16	Opening balance**(1)**	192,500	30-06-17	Cash	6,885,400
30-06-17	Credit sales**(1)**	6,930,000	30-06-17	Bad debts**(1)**	4,600
			30-06-17	Closing balance**(1)**	232,500
		7,122,500			7,122,500
01-07-16	Balance b/d	232,500			

(i.e. $6,885,400 carried forward to Statement of cash flows = 4 marks)

Accounts payable

Date	Account	$	Date	Account	$
30-06-17	Cash at bank	4,343,600	01-07-16	Opening balance**(1)**	560,000
30-06-17	Closing balance**(1)**	670,400	30-06-17	Purchases**(1)**	4,454,000
		5,014,000			5,014,000
				Balance b/d	670,400

(i.e. $4,343,600 carried forward to Cash payments to suppliers and employees = 3 marks)

Selling and distribution expense

Date	Account	$	Date	Account	$
30-06-17	Cash at Bank	431,000	01-07-16	Opening balance**(1)**	42,000
30-06-17	Closing balance**(1)**	56,000	30-06-17	Profit or Loss**(1)**	445,000
		487,000			487,000
			01-07-16	Balance b/d	56,000

(i.e. $431,000 carried forward to Cash payments to suppliers and employees = 3 marks)

Accrued interest expense/Interest expense

Date	Account	$	Date	Account	$
30-06-17	Cash at bank	18,000	01-07-16	Opening balance**(1)**	45,000
30-06-17	Closing balance**(1)**	67,000	30-06-17	Profit or Loss**(1)**	40,000
		85,000			85,000
			01-07-16	Balance b/d	67,000

(i.e. $18,000 carried forward to Statement of cash flows = 3 marks)

Other expenses

Date	Account	$	Date	Account	$
30-06-17	Depreciation: equip**(1)**	123,500	30-06-17	Profit or Loss**(1)**	258,800
	Loss – sale: equip**(1)**	16,700			
	Doubtful debts**(1)**	6,500			
	Cash at bank	112,100			
		258,800			258,800

(i.e. $112,100 carried forward to Cash payments to suppliers and employees = 4 marks)

Question 20 (continued)

Cash payments to suppliers and employees		**Marks**
	$	
Accounts payable	4,343,600	3
Salaries and wages	700,000	1
Selling and Distribution	431,000	3
Other Expenses	112,100	4
	5,586,700	
	Total	**11**

(i.e. $5,586,700 carried forward to Statement of cash flows = 11 marks)

NOTE: No cash is received from Dividend revenue during the period.

Deduct 1 mark for a calculation error, to a maximum of 1 mark.

Galle Gold Ltd
Statement of Cash flows (extract)
for the year ended 30 June 2017

Cash flows from Operating Activities	$	**Marks**
Receipts from customers	6,885,400	4
Payments to suppliers and employees	(5,586,700)	11
Cash generated from operations	1,298,700	1
Income tax paid	(299,760)	1
Interest paid	(18,000)	3
Net cash inflows from operating activities	980,940	1
	Total	**21**

Deduct 1 mark for including cash from Dividend revenue and additional non-relevant items, to a maximum of 1 mark.

(b) (i) Explain why the profit after tax is different from the net operating cash flows. (2 marks)

Description	**Marks**
Explains why profit is different from net operating cash flows	2
Provides a limited explanation of why profit is different from net operating cash flows	1
Total	**2**
Answers could include: The operating profit after tax is calculated using accrual accounting where revenues are recognised when earned and expenses are recognised when incurred. On the other hand, net operating cash flows are calculated on the basis of when cash is received for operating revenues and cash is paid for operating expenses.	
Accept any other reasonable answer.	

(b) (ii) Identify and explain **one** item that is dealt with in different ways by the Statement of comprehensive income and the Statement of cash flows for the year ended 30 June 2017. (3 marks)

Description	Marks
Identifies an item that is treated differently in the statements	1
Subtotal	**1**
Explains how the item is dealt with in both statements	2
Explains how the item is dealt with in one statement	1
Subtotal	**2**
Overall total	**3**
Answers could include: • sales revenue is recognised as earned in the Statement of comprehensive income (i.e. \$6,930,000) whereas revenue is only recognised in the Statement of cash flows as the cash received (i.e. \$6,885,400) • in terms purchases, the cost of inventory purchased and used (i.e. cost of goods sold of \$4,430,000) is recognised in the Statement of comprehensive income when the inventory is acquired and subsequently sold, whereas purchases are only recorded in the Statement of cash flows when inventory purchased on credit is actually paid for (i.e. \$4,343,600) • depreciation (i.e. \$123,500), profits or losses on the disposal of non-current assets (i.e. the loss of \$16,700) and doubtful debts expense (i.e. \$6,500) are recognised in the Statement of comprehensive income as an expense, whereas because these items are non-cash expenses or losses, they are not recognised at all in the calculation of net operating cash flows in the Statement of cash flows • due to accruals for interest receivable, dividend receivable and interest payable, dividend and interest revenue and interest expense recorded in the Statement of comprehensive income could be different to dividends and interest received and interest paid in the Statement of cash flows • taxes paid (i.e. \$299,760) could be different to tax expense (i.e. \$322,560).	
Accept any other reasonable answer.	

Section Three: Extended answer **15% (30 Marks)**

Question 21 **(30 marks)**

(a) If APPA were to voluntarily embrace corporate social disclosure, identify and explain **two** uses that APPA's shareholders might expect to make from the disclosure. (6 marks)

Description	Marks
For each of **two** uses shareholders might make of CSD:	
Identifies and explains a use that a shareholder might make of CSD	3
Identifies and briefly explains a use that a shareholder might make of CSD	2
Identifies a use a shareholder might make of CSD	1
Total	**6**
CSD assists existing investors to make decisions about whether to maintain, increase or decrease their investment in APPA based on the company's CSD and the values held by shareholders because they will use these disclosures to: • assure themselves that the company is proactively managing the current cost of compliance with social and environmental regulation, thereby mitigating the risk of government intervention and financial impacts of future regulation • assist with monitoring the company's performance and the quality of management decision-making and board oversight of managerial decision-making • provide company-sourced information about information reported in the company's own financial statements (e.g. reasons for investment in new manufacturing technology) or to respond to reports made in the media about the company's performance • affirm the quality of the relationships the company has with trading parties (e.g. suppliers and customers), lenders and employees.	
Accept any other reasonable answer.	

(b) Describe **three** financial statements that would form part of APPA's general purpose financial reports for a financial year. (6 marks)

Description	Marks
For each of **three** financial statements:	
Describes a financial statement	2
Identifies and provides a limited description of a financial statement	1
Total	**6**

Any **three** of the following financial statements could be given:

- the accrual based Statement of comprehensive income. APPA's Statement of comprehensive income measures the performance of the company and reports (a) the profit or loss; (b) total other comprehensive income; (c) comprehensive income for the period, being the total of profit or loss and other comprehensive income
- the accrual based Statement of financial position. APPA's Statement of financial position measures the company's financial position and reports the company's (a) assets, (b) liabilities and (c) shareholders' equity at a point in time. APPA's Statement of financial position provides the company's shareholders an appreciation of what assets APPA controls and the amounts owes in the form of liabilities as opposed to what they have invested in the company
- the cash based Statement of cash flows. APPA's Statement of cash flows reports how the cash-related activities of the company (e.g. receipts and payments) have affected the company's cash position during the period. The cash-related activities are classified into one of three categories (a) operating, (b) investing and (c) financing
- the accrual based Statement of changes in equity. APPA's Statement of changes in equity reports the changes that have occurred in the company's equity and discloses (a) total comprehensive income for the period and (b) for each component of equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately (as a minimum) disclosing changes resulting from (i) profit or loss (ii) other comprehensive income and (iii) transactions with owners in their capacity as owners, showing separately contributions made by and distributions made to owners.

Question 21 (continued)

(c) When APPA reports to external users, **The** *Framework for the Preparation and Presentation of General Purpose Financial Reports (The Framework)* identifies the qualitative characteristics that are to be applied to information for it to be considered useful.

Explain how management determines whether or not to include information in the reports based on the qualitative characteristics of:

(i) relevance (6 marks)

Description	Marks
Explains relevance in detail with reference made to materiality	5–6
Explains relevance with limited reference made to materiality	3–4
Provides a limited explanation of relevance with no reference made to materiality	1–2
Total	**6**

Answers could include:

The Framework defines relevance as ‘Relevant financial information is capable of making a difference in the decisions made by users’ and ‘financial information is capable of making a difference in decisions if it has predictive value, confirmatory value, or both’.

Thus, in terms of whether or not to include information in the reports based on the qualitative characteristic of relevance, APPA’s management would:
- assume that all general purpose financial report users rely in part upon the information reported in that report
- the information to be reported must be capable of making a difference in the decisions made by the users of financial information
- where information that is price-sensitive becomes known by APPA’s management, it must be disclosed in a timely manner.

In terms of what relevant information is, the concept of materiality must also be considered. The Framework defines materiality as ‘Information is material if omitting it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting entity. Materiality is an entity-specific aspect of relevance based on the nature or magnitude (or both) to which the information relates in the context of an individual entity’s financial report’.

The relevance qualitative characteristic coupled with the notion of materiality, for which APPA determines according to the nature or magnitude of items for the information to be disclosed, ensures that all users have access to financial information that will substantively influence (i.e. that is material to) the decisions that they are to make. Thus, if financial information is to be reported by APPA, the company’s management must believe that it useful to those making investment decisions.

Accept any other reasonable answer.

(ii) faithful representation (which has replaced reliability). (6 marks)

Description	Marks
For each of the **three** underlying characteristics of faithful representation:	
Identifies and explains the characteristic	2
Identifies the characteristic	1
Total	**6**
Answers could include: Faithful representation seeks to maximise the underlying characteristics of complete, neutral and free from error. Complete: Complete means that APPA ensures that adequate or full disclosure of all necessary information has been provided to external users. This means that APPA cannot exclude financial and non-financial information that would be deemed to be relevant to the decision-making needs of external users of its disclosures. Neutral: Information that is neutral is presented without bias. The framework states that 'A neutral depiction is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users.' Free from error: In terms of how faithful representation applies to the reports that APPA prepares for external users, it does not mean that the financial information is accurate in all respects. Key points to note in respect to free from error include: • free from error means there are no errors or omissions in the description of the phenomenon by APPA • the process used by the company to produce the reported information has been selected and applied with no errors in the process thus, free from error does not mean that APPA is able to provide financial information that is perfectly accurate in all respects. APPA should only disclose financial information when external users have confidence in being able to rely on that information as it is what it purports to be.	
Accept any other reasonable answer.	

Question 21(c) (continued)

(iii) timeliness. (2 marks)

Description	Marks
Explains the characteristic of timeliness	2
Defines the characteristic of timeliness with no explanation	1
Total	**2**
Answers could include: The Framework defines timeliness as 'having information available to decision makers in time to be capable of influencing their decisions'. Generally information that is older is less useful to users of financial reports. Some information continues to be useful long after the reporting period has ended, for example in helping the external user to identify possible trends in the data. For financial information to be useful, it must be disclosed in a timely manner.	
Accept any other reasonable answer.	

(d) The Australian Securities and Investment Commission (ASIC) have a legislated interest in registered companies. Explain briefly the role of ASIC and its importance to APPA's existing and potential investors. (4 marks)

Description	Marks
Role of ASIC:	
Explains the role of ASIC	2
Makes a relevant statement about the role of ASIC	1
Subtotal	**2**
ASIC's importance to investors:	
Explains the importance of ASIC to investors	2
Makes a relevant statement about the importance of ASIC to investors	1
Subtotal	**2**
Overall total	**4**
Answers could include: The Australian Securities and Investment Commission (ASIC) roles include: • ASIC has substantial enforcement powers relating to corporate financial reporting and audit under the *Corporations Act*, the *ASIC Act*, and the various state crimes acts • ASIC can make orders to require compliance; institute legal proceedings which can produce outcomes that carry heavy civil and criminal penalties; direct companies to prepare and lodge reports; seek injunctions to restrain contravention of the *Corporations Act*; and investigate matters where it believes the *Corporations Act* or other corporate laws have been broken • ASIC also regulates and informs the public about Australian companies In respect to ASIC's importance to APPA's existing and potential investors: • through its ability to monitor the financial disclosures and assurance (i.e. audit) of APPA's general purpose financial reports, existing and potential investors will have greater confidence in their ability to make their investment decisions • with greater stability and confidence in the regulation of capital markets afforded by ASIC's activities, existing and potential investors in APPA will be attracted to the equities market and the company as they perceive that there is a reduction in the risk associated with their investment decisions • as directors will be encouraged, via ASIC's monitoring activities and the prosecution of breaches, to make decisions and behave in ways that are in the best interests of investors, consumers and creditors, existing and potential investors in APPA will have confidence in the quality of the decisions taken and behaviours of the company's directors.	
Accept any other reasonable answer	

Question 22 **(30 marks)**

(a) In terms of the costs of manufacturing and selling electric toys by Toddlersmart distinguish between:

(i) fixed and variable costs. (4 marks)

Description	Marks
Distinguishes clearly between fixed and variable costs	3–4
Provides a simple distinction between fixed and variable costs	1–2
Total	**4**
Answers could include: Within a level of production/relevant range of activity, a fixed cost is one that does not change in total relative to the changes in that production level/activity base. Within a level of production/relevant range of activity, a variable cost changes in direct proportion to the changes in that level of production/activity base (e.g. a 10 per cent increase in manufacturing output will yield a 10 per cent increase in total variable manufacturing-related costs). Thus, within a relevant range of activity, the distinction between fixed costs and variable costs is that total fixed costs are unaffected by changes in production/activity whereas total variable cost will change in direct proportion to the change in production/activity.	
Accept any other reasonable answer.	

(ii) product and period costs. (4 marks)

Description	Marks
Distinguishes clearly between product and period costs	3–4
Provides a simple distinction between product and period costs	1–2
Total	**4**
Answers could include: A product cost is one that relates to manufacture of a product that is expected to generate economic benefits (i.e. sales revenue) when disposed of by the business. Until the product is completed and sold, product costs are ‘inventoriable’ in the form of work-in-progress or finished goods inventory. Upon being sold, product costs become the expense cost of goods sold (i.e. cost of sales). Period costs are not related to the manufacturing process and cannot be assigned to the cost of manufacturing products or to the cost of unsold finished goods inventory. Thus, period costs are recorded as expenses in the period incurred, expired or periods when they relate to, or can be matched with, future revenues (e.g. the carrying amount of depreciable non-manufacturing assets). The distinction between product costs and period costs is that the former relates to the manufacture of the asset ‘inventory’ and can only become an expense when sold whereas the latter is an expense when incurred, expired or matched with associated revenue.	
Accept any other reasonable answer.	

(b) It has been suggested by some that if sales of this toy continue to decline, the automated manufacturing facility should be closed down. Others however, argue that given the size of the investment it should remain open and operational. Explain why the initial investment of $5 million can be ignored when future production decisions are made and outline what future production decisions should be based on. (6 marks)

Description	Marks
Why initial investment can be ignored:	
Explains why the initial investment can be ignored in future decisions	2
Provides a limited explanation of why the initial investment can be ignored in future decisions	1
Subtotal	**2**
Future production decisions:	
Outlines what future production decisions should be based on	3–4
Provides a limited outline regarding what future production decisions should be based on	1–2
Subtotal	4
Overall total	**6**
Answers could include: Why initial investment can be ignored: Toddlersmart can ignore the $5 million cost of the automated manufacturing facility when making future production decisions as it is a past (sunk) cost. Past costs are those that have already been incurred and therefore will not change. These costs have no impact on future investment options/decisions and should not be considered. Future production decisions: For future production decisions, the only financial factors that are of decision-making value are relevant revenues and costs. By eliminating irrelevant costs, such as the $5 million past cost of the automated manufacturing facility or committed but non-cash costs such as depreciation, Toddlersmart is able to focus only on that data that is relevant to the future and that will be affected by the production planning decisions made now and at later points in time. When making future production decisions Toddlersmart may consider: • the possibility of reducing costs e.g. alternative suppliers, avoidable costs • the effect on fixed costs if production of the toy ceases • customer demand and preferences and their likely impact on future sales.	
Accept any other reasonable answer.	

Question 22 (continued)

(c) Explain the difference between cost leadership and differentiation. Provide evidence to identify when Toddlersmart Ltd has employed each of these strategies. (6 marks)

Description	Marks
Difference between cost leadership and differentiation:	
Explains the difference between cost leadership and differentiation	3–4
Provides a limited description of the difference between cost leadership and differentiation	1–2
Subtotal	**4**
For each of the **two** strategies:	
Identifies when it has been used	1
Subtotal	**2**
Total	**6**
Answers could include: Difference between cost leadership and differentiation: Cost leadership is where a business competes by seeking to supply a product or service at a price lower than its rivals. Product differentiation is where a business competes by seeking to supply a product or service to its customers that is unique or different to those supplied by its rivals (i.e. high product quality of branding). In summary, the difference between cost leadership and differentiation is that a cost leadership competitive strategy is one based on price whereas the differentiation strategy is based on differentiating factors such as quality and branding. Strategies employed: • Differentiation appears to have been employed by the business at the time it launched the new toy. At this time Toddlersmart had no competitors and could set its own price • Cost leadership appears to have been employed by the business once a competitor introduced their product to the Australian market. At this time Toddlersmart reduced its selling price to retain a profitable share of the market.	
Accept any other reasonable answer.	

(d) For many manufacturing businesses, non-current assets constitute a significant proportion of total assets. Explain **three** financial principles of asset management as they apply to maintaining appropriate levels of investments in non-current assets.

(6 marks)

Description	Marks
For each of the **three** principles of asset management:	
Explains a principle of asset management	2
Identifies a principle of asset management	1
Total	**6**
Answers could include: As non-current assets represent the base upon which the revenue-earning capacity of many businesses rely, they must be effectively managed. In terms of the specific application of the financial principles of asset management to non-current assets: • ensure security of non-current assets through the financial risk coverage provided in the form insurance and physically with appropriate mechanisms such as controlled access to moveable items or other security devices including permanent locking devices (e.g. bolts and cabling) that prevent the unauthorised removal of an item • maintain appropriate records that document the existence of each non-current asset (e.g. a non-current or fixed asset register) and its operational performance (e.g. production output, capacity utilisation and repair and maintenance history) • each business must have an appropriate level of non-current assets to maintain the efficient supply of products that generate required levels of future economic benefits in the form of income and operating cash inflows and that ensures the operational and financial sustainability of the business • a decision to invest in non-current assets must be examined on its own merits, including the costs and benefits of any non-current asset to be acquired and how it fits with the future plans of the business • an over-investment in non-current assets can result in the underutilisation of assets which means that the cost of the unutilised capacity is to the detriment of the future operational and financial viability of the business. Assets surplus to need could be partly sold or leased to other parties so as to ease the burden of the unused capacity.	
Accept any other reasonable answer.	

Question 22 (continued)

(e) The management of the company has recently been in meetings with the internal auditors who have stressed the importance of accounting standards when completing their financial reports. Outline **two** purposes of accounting standards. (4 marks)

Description	Marks
For each of the **two** purposes of accounting standards:	
Outlines the purpose in detail	2
Provides a brief outline of the purpose	1
Total	**4**
Answers could include: Accounting standards regulate the form and content of general purpose financial reports (GPFR) and thereby assure existing and potential investors and lenders that the financial information is both relevant and a faithful representation of the financial performance and position of the reporting entity. Thus, accounting standards provide several purposes: • protect external users – by complying with accounting standards, a company will fairly present its financial position, financial performance and cash flows. This information will be useful to existing and potential investors, creditors, analysts, employees, regulators and other external parties in making and evaluating decisions about the allocation of scarce economic resources • assist directors in discharging their obligations – as GPFRs are one of many ways for the management and board of directors to be accountable to those who provide resources to a company, compliance with accounting standards ensures a higher level of accountability is achieved and promotes accurate reporting • providing confidence to investors in Australian capital markets – by complying with accounting standards, companies produce reports that can be relied upon by investors, therefore engendering confidence in the information available to them and the processes used to produce the reports.	
Accept any other reasonable answer.	

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