Marking Key

ACCOUNTING AND FINANCE

Year 12 ATAR

Units 3 & 4

2016 BEWA Semester Two Examination

Analysis of questions by practical and theory

Question No	Practical	Theory	Unit 3	Unit 4	Question No	Practical	Theory	Unit 3	Unit 4
Sec 1					**20**				
1	1		1		a	18			18
2	1		1		b	4			4
3		1	1		**c**	7			7
4	1		1		d		4		4
5	1		1		21 a	17			17
6		1	1		b	15			15
7		1	1		c	6			6
8		1	1				2		2
9		1	1						
10		1	1		**Total**	**109**	**21**	**57**	**73**
11		1		1	**70%**	**59%**	**11%**	**31**	**39**
12		1	1		**Sec 3 22a**		9		9
13		1		1	b		6		6
14		1		1	c		3		3
15		1		1	d		6	6	
Total	**4%**	**11%**	**11**	**4**	e		6	6	
Sec 2					**Total**		**30**	**12**	**18**
16									
a	4		4		**OR**				
b		2	2		22 a		9		9
c	3		3		b		6		6
d		1	1		c		3		3
e		2	2		d		6	6	3
					e		6	6	
17									
a	3		3		**Total**		**30**	**12**	**18**
b	7		7				**15%**	**6%**	**9%**
c		3	3						
18 a	9		9		**Sec 1**	**4**	**11**	**10**	**5**
b		1	1		**Sec 2**	**59**	**11**	**31**	**39**
c		4	4		**Sec 3**		**15**	**6**	**9**
19					**Total**	**63%**	**37%**	**47%**	**53%**
a	3		3						
b	13		13						
c		2	2						

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

This section has **15** questions. Each question is worth **one** mark. Attempt **all** questions.

1.	B
2.	C
3.	B
4.	D
5.	D
6.	A
7.	C
8.	A
9.	D
10.	C
11.	B
12.	B
13.	A
14.	A
15.	C

Section Two: Short answer 70% (120 Marks)

This section has **six** questions. Answer **all** questions. Write your answers in the space provided.

Instructions for teachers:

- **Allow for follow through errors; that is consequential errors should not be penalised**
- **Marks should not be subtracted for incorrect solutions**
- **Accept any other reasonable answers when marking theory questions**

Question 16 (12 marks)

(a) Calculate the direct materials usage variance. (4 marks)

(AQI – SQA*) × SP
(1 060 sqm – 1 000 sqm (ie. 2 x 500)) x $26 = **$1 560 U**
(1) (2) (1)
OR
(SP × AQI) – (SP × SQA)
($26 x 1 060 sqm) – ($26 x 1 000 sqm (ie. 2 x 500)) = $1 560 U
(1) (1) (2)

(a) Identify two strategies management could use to improve an unfavourable direct material usage variance. (2 marks)

- Purchase better quality material to reduce breakage/wastage
- Improve chair design to eliminate wastage
- Provide further training to staff to reduce wastage
- **Any two reasonable points (2)**

(b) Calculate the direct labour rate variance (3 marks)

(AR – SR) × ADLH
($63.00 - $60.00) x 240 hrs = $720 U
(1) (1) (1)
OR
(AR × ADLH) – (SR × ADLH)
($63.00 x 240 hrs) – ($60.00 x 240 hrs) = $720 U
(1) (1) (1)

(c) Explain why the direct labour rate variance is favourable or unfavourable. (1 mark)

The direct labour rate variance is unfavourable because the cost of labour was more expensive than anticipated. **(1)**

(d) The owners of Hobart Enterprises have questioned why the glue, wood stain and varnish are not classified as direct manufacturing costs. Provide a suitable explanation. (2 marks)

Direct product costs are readily identifiable and traced to the product being manufactured. **(1)**

The amount of glue, wood stain and varnish required for each chair is difficult to quantify or measure for each chair, hence it is an indirect cost.**(1)**

Question 17 **(13 marks)**

(a) Calculate the payback period (in years and months) for Machine B. (3 marks)

Payback period = Initial cost of investment/annual net cash flows
= $600 000/$170 000
(1) **(1)**
= 3.529 years
Therefore 0.529 x 12 months = 6.348 months
(1)
Therefore 7 months
The payback period is 3 years and 7 months
Note: as the payback period is less than the useful life of 6 years the residual value of $40 000 is not required in the calculation.

(b) Calculate the net present value for Machine B. (7 marks)

Note: The net cash flows are an annuity as they are constant each year.
Net present value:

= Present value of net cash flows – present value of the cost of the investment
= $170 000 $_{12\%]6}$ + $40 000/$[1 + 0.12]^6$ - $500 000 - $100 000/$[1 + 0.12]^1$
= $170 000 x 4.1114 + $40 000 x 0.5066 - $500 000 - $100 000 x 0.8929
(1) **(1)** **(1)** **(1)** **(1)** **(1)** **(1)**
= $698 938 + $20 264 - $500 000 - $89 290
= **+ve $129 912**
OR

Years 1-5	170 000 x 3.6048	= 612 816 **(2)**
6	170 000 + 40 000 x 0.5066	= <u>106 386</u> **(2)**
		= 719 202

NPV = 719 202 – 500 000 **(1)** – (100 000 x 0.8929) **(2)**
= $129 912

(c) Based on the calculations, which machine should be purchased and why? (3 marks)

Machine B should be purchased. **(1)**
This is because Machine B has a payback period of 3 years and 7 months which is less than that for Machine A of 3 years and 8 months, **(1)** and the net present value for Machine B of +ve $129 912 is greater than that of Machine A which is +ve $115 000. **(1)**

Question 18 **(14 marks)**

(a) Calculate the gain or loss on the special order. (9 marks)

Workings:
Note 1:
Variable cost per unit of special order = $16.50 **(1)** – $1.00 **(1)** = $15.50 per unit

Note 2:
Spare capacity = Maximum capacity 5 000 units ─ Current production 4 500 units
= 500 units **(1)***

Lost production = Special order 700 pots **(1)** – 500 spare capacity **(1)***
= 200 units**

Opportunity (future) cost = 200 pots **(2)** x (35 **(1)** – 16.50 **(1)**)
= 200 x 18.50
= $3 700

Calculation of gain or loss on special order:

			Marks
Sales - special order	#700 units **(1)** × $30.00 **(1)**	$21 000	**2**
Less variable costs – special order	#700 units × $15.50 **(2)** **Note 1**	$10 850	**2**
Contribution Margin		$10 150	
Less equipment. modifications		$1 000	**1**
Less opportunity cost - **Note 2**		$3 700	**4**
Gain on special order		**$5 450**	

(b) Should Launceston Traders accept or reject the special order based on the quantitative calculation? (1 mark)

Launceston Traders should accept the special order as they have made a gain of $5 450. **(1)**

(c) Distinguish between a past and future cost using examples from the special order calculated in (a) to illustrate your answer. (4 marks)

The cost of the existing production equipment purchased 5 years ago at a cost of $25 000 cannot be changed and is therefore a past cost, that is a sunk cost. **(1)** It has no bearing on whether we consider to accept the special order or not and is therefore not relevant to the calculation of the special order. **(1)**

A future cost is relevant to the calculation of the special order gain or loss as it is a point of difference between the two alternatives - that is, to consider the acceptance of the special order or to not accept it. **(1)** In this case the opportunity cost is a future cost – because if the special order is accepted then normal production needs to be reduced and the business could lose some of their regular customers resulting in lower sales income. **(1)**

Question 19 **(18 marks)**

(a) Prepare the Schedule of Receipts from Accounts Receivables for Normandy Wholesalers for the month ending 31 October 2016. (3 marks)

Schedule of Receipts from Credit Sales in October 2016

Month of sale		**$**	**Marks**
July	$82 000 x 8%	6 560	**1**
August	$83 000 x 25%	20 750	**1**
September	$88 000 x 65%	57 200	**1**
Total		84 510	**Total = 3***

(b) Prepare the cash budget for Normandy Wholesalers for the month ending 31 October 2016. (13 marks)

Workings:
Payment for credit purchases: $57 000 **(1) x 98% **(1)** = $55 860

*****Loan interest: 40 000 x 6% **(1)** x 1/12 **(1)** = 200

Normandy Wholesalers
Cash Budget
For the month ending 31 October 2016

	$	**Marks**
Opening cash balance	15 820	**1**
Add Estimated Cash Receipts:		
Cash Sales	36 000	**1**
Receipts from Debtors	84 510	**1* part (a)**
Loan	40 000	**1**
Total cash available	$176 330	
Less Estimated Cash Payments		
Credit purchases	55 860	**2****
Wages and salaries	6 800	**1**
Electricity	800	**1**
Office costs	650	**1**
Equipment	40 000	**1**
Loan repayment	1 000	**1**
Loan interest	200	**2*****
Total cash payments	$105 310	
Closing cash balance	**$71 020**	

(c) Outline **two** reasons why cash is so important to the viability of a business.
(2 marks)

Cash is the most necessary financial factor to:

- Pay for expenses such as wages, advertising, electricity, interest and office costs as required.
- Repay debts such as mortgage loans and accounts payable.
- Expand the business through the acquisition non-current assets.
- Show lenders and creditors that the business can repay debts and develop a good credit rating.
- Borrow future cash funds to purchase goods and supplies on credit.
- Pay dividends to shareholders/owners.
- Survive economic downturns and have the ability to pay debts and expenses so as to avoid bankruptcy.
- Pay debts on time and therefore avoid paying extra interest.
- Respond to any problems which may emerge and be able to make critical decisions.

Students should give two (2) points from the above or other reasonable answer each worth one (1) mark.

Question 20 **(33 marks)**

Required:

(a) Calculate the total payments to suppliers and employees for Kelsey Ltd for the year ending 30 June 2016. (18 marks)

Payments to suppliers and employees:			**Marks**
• Creditor	$92 500		**5**
• Other cash expenses	$7 000		**7**
• Insurance	$2 200		**3**
• Salaries	$22 800	($124 500)	**3**

Workings:

Inventory account

Date	**Account**	**Amount $**	**Date**	**Account**	**Amount $**
1/7/15	Opening Balance**(1)**	51 000	30/6/16	Cost of Sales **(1)**	75 000
30/6/16	Creditors*	83 000	30/6/16	Closing Balance **(1)**	59 000
		134 000			134 000
				Total marks	**3**

OR

Date	**Details**	**Debit $**	**Credit $**	**Balance $**
1/7/15	Opening Balance **(1)**			51 000 Dr
30/6/16	Cost of Sales **(1)**		75 000	24 000 Cr
30/6/16	Creditors*	83 000		59 000 Dr **(1)**
			Total marks	**3***

Creditors account

Date	**Account**	**Amount $**	**Date**	**Account**	**Amount $**
30/6/16	Cash*	92 500	1/7/15	Opening Balance **(1)**	70 000
30/6/16	Closing Balance **(1)**	60 500	30/6/16	Inventory **(3)***	83 000
		153 000			153 000
				Total marks	**5**

OR

Date	**Details**	**Debit $**	**Credit $**	**Balance $**
1/7/15	Opening Balance **(1)**			70 000 Cr
30/6/16	Inventory **(3)***		83 000	153 000 Cr
30/6/16	Cash*	92 500		60 500 Cr **(1)**
			Total marks	**5**

Other cash expenses:
Other expenses $11 500 **(1)** – Loss on Sale of Machine $2 000 **(3)** – Doubtful Debts $2 500 **(3)** = $7 000. **Total marks = 7 marks**

Sale of Machinery account

Date	Account	Amount $	Date	Account	Amount $
30/6/16	Machinery **(1)**	12 000	30/6/16	Accumulated Depreciation on Machinery **(1)**	6 000
			30/6/16	Cash proceeds **(1)**	4 000
			30/6/16	Loss on disposal of Machinery*	2 000
		12 000			12 000
				Total marks	**3**

OR

Date	Details	Debit $	Credit $	Balance $
30/6/16	Machinery **(1)**	12 000		12 000 Dr
30/6/16	Accumulated Depreciation on Machinery **(1)**		6 000	6 000 Dr
30/6/16	Cash proceeds **(1)**		4 000	2 000 Dr
30/6/16	Loss on Sale of Machinery*		2 000	0
			Total marks	**3**

OR

Gain/Loss on sale = proceeds 4 000 **(1)** – carrying amount (12 000 – 6 000) **(2)** = $2 000

Allowance for Doubtful Debts account

Date	Account	Amount $	Date	Account	Amount $
30/6/16	Bad debts **(1)**	2 000	1/7/15	Op Balance **(1)**	1 000
	Cl Balance **(1)**	1 500	30/6/16	Doubtful debts*	2 500
		3 500			3 500
				Total marks	**3**

OR

Date	Details	Debit $	Credit $	Balance $
1/7/15	Opening balance **(1)**		1 000	1 000 Cr
30/6/16	Doubtful debts		2 500	3 500 Cr
30/6/16	Bad debts **(1)**	2 000		1 500 Cr **(1)**
			Total marks	**3**

Prepaid Insurance account

Date	Account	Amount $	Date	Account	Amount $
1/7/15	Opening Balance**(1)**	2 000	30/6/16	Insurance Expense **(1)**	1 200
30/6/16	Cash*	2 200	30/6/16	Closing Balance **(1)**	3 000
		4 200			4 200
				Total marks	**3**

OR

Date	Details	Debit $	Credit $	Balance $
1/7/15	Opening Balance **(1)**			2 000 Dr
30/6/16	Cash*	2 200		4 200 Dr
30/6/16	Insurance Expense **(1)**		1 200	3 000 Dr **(1)**
			Total marks	**3**

Salaries account

Date	Account	Amount $	Date	Account	Amount $
30/6/16	Cash*	22 800	1/7/15	Accrued Expenses **(1)**	800
30/6/16	Accrued Expenses **(1)**	1 000	30/6/16	Profit and Loss Summary **(1)**	23 000
		23 800			23 800
				Total marks	**3**

OR

Date	Details	Debit $	Credit $	Balance $
1/7/15	Accrued Expenses **(1)**		800	800 Cr
30/6/16	Cash*	22 800		22 000 Dr
30/6/16	Accrued Expenses **(1)**	1 000		23 000 Dr
30/6/16	Profit and Loss Summary **(1)**		23 000	0
			Total marks	**3**

(b) Prepare the Investing Activities section of the Statement of Cash Flows for Kelsey Ltd for the year ending 30 June 2016. (4 marks)

Cash Flows from Investing Activities			**Marks**
Purchase of machinery	($15 000)		**3**
Receipt from machinery sale	$4 000		**1**
Net Cash Flows from Investing Activities		($11 000)	

Workings:

Machinery account

Date	**Account**	**Amount $**	**Date**	**Account**	**Amount $**
1/7/15	Opening Balance **(1)**	68 000	30/6/16	Sale of Machinery **(1)**	12 000
30/6/16	Cash*	15 000	30/6/16	Closing Balance **(1)**	71 000
		83 000			83 000
				Total marks	**3**

OR

Date	**Details**	**Debit $**	**Credit $**	**Balance $**
1/7/15	Opening Balance **(1)**			68 000 Dr
30/6/16	Sale of Machinery **(1)**		12 000	56 000 Dr
30/6/16	Cash*	15 000		71 000 Dr **(1)**
			Total marks	**3**

(c) Prepare the Financing Activities section of the Statement of Cash Flows for Kelsey Ltd for the year ending 30 June 2016. (7 marks)

Cash Flows from Financing Activities			**Marks**
Dividends paid	($33 300)		**5**
Receipts from share issue	$13 000		**2**
Net Cash Flows from Financing Activities		($20 300)	

Workings:
General Reserve Transfer: $21 000 **(1)** – $9 000 **(1)** = $12 000 **(2)**#
Share issue: $146 000 **(1)** - $133 000 **(1)** = 13 000 **(2)**

Retained Earnings account

Date	**Account**	**Amount $**	**Date**	**Account**	**Amount $**
30/6/16	Final Dividends Payable*	33 300	1/7/15	Opening Balance **(1)**	55 000
30/6/16	General Reserve **(2)**#	12 000	30/6/16	Profit and Loss Summary **(1)**	50 300
30/6/16	Closing Balance **(1)**	60 000			
		105 300			105 300
				Total marks	**5**

OR

Date	**Details**	**Debit $**	**Credit $**	**Balance $**
1/7/15	Opening Balance **(1)**			55 000 Cr
30/6/16	Profit and Loss Summary **(1)**		50 300	105 300 Cr
30/6/16	General Reserve **(2)**#	12 000		93 300 Cr
30/6/16	Final Dividends Payable		33 300	60 000 Cr **(1)**
			Total marks	**5**

(d) Define cash and cash equivalents as stated in Australian Accounting Standards Board AASB 107. (4 marks)

According to Australian Accounting Standard (AASB) 107 cash is defined as comprising cash on hand and demand deposits. **(1)** Cash on hand is notes and coins held on the business premises. Demand deposits are amounts held in financial institutions that the business can withdraw at any time and are not deposited for any specific period of time. **(1)**

Cash equivalents are defined in AASB 107 as short-term, highly liquid investments that are readily convertible to known amounts of cash **(1)** and which are subject to an insignificant risk of change in value. **(1)**

Question 21 **(40 marks)**

(a) Prepare a Statement of Comprehensive Income for Fahrrad Ltd for the year ended 30 June 2016. (17 marks)

Fahrrad Ltd
Statement of Comprehensive Income
For the year ending 30 June 2016

		$	Marks
Revenue		$201 000	**1**
Cost of sales		(92 000)	**1**
Gross profit		**$109 000**	
Other income		2 000	**1**
Expenses excluding finance costs	**(a)**	(99 050)	**9**
Finance costs	**(b)**	(4 500)	**2**
Profit Before Income Tax		**$7 450**	
Income tax expense	**(c)**	2 235	**1**
Profit for the Period		**$5 215**	
Other Comprehensive Income			
Gain on asset revaluation	**(d)**	110 000	**2**
Total comprehensive income for the period		**$115 215**	

Workings:

				Marks
(a) Other expenses	Wages	$79 500	**$99 050**	**1**
	Discount Allowed	$500		**1**
	Shop Rent ($9 800 - $2 500)	$7 300		**2**
	Insurance	$7 500		**1**
	Other	$1 850		**1**
	Cartage outwards	$2 100		**1**
	Depreciation on Motor vehicles (10% × $12 000 × 3/12)	$300		**2**
(b) Finance expenses	Loan interest $3 500 **(1)** + 1 000 **(1)** = $4 500		**$4 500**	**2**
(c) Income tax	$7 450 x 30% = $2 235		**$2 235**	**1**
(d) Gain on asset revaluation	Land $280 000 **(1)** – 170 000 **(1)** = $110 000		**$110 000**	**2**

(b) Prepare the Statement of Changes in Equity for Fahrrad Ltd for year ending 30 June 2016. (15 marks)

Workings:

*Bonus issue = 1/10 × 102 000 × $2.00 = $20 400
(1) **(1)** **(1)**

Fahrrad Ltd.
Statement of Changes in Equity
For the year ending 30 June 2016

	$	**MARKS**
Profit for the year	5 215	**1**
Gain on revaluation of assets	110 000	**1**
Total comprehensive income for the year	**115 215**	
Share capital		
Balance at the start	204 000	**1**
Issue of share capital **	20 400	**3***
Balance at the end of the year	**224 400**	
Other components of equity		
General reserve		
Balance at the start	10 000	**1**
Transfer from retained profits	5 000	**1**
Balance at the end	**15 000**	
Asset revaluation reserve		
Balance at the start	0	**1**
Gain on revaluation	110 000	**1**
Bonus share issue	(20 400)	**1**
Balance at the end	**89 600**	
Total – other components of equity	**104 600**	
Retained earnings		
Balance at the start	76 000	**1**
Profit for the period	5 215	**1**
Transfer to general reserve	(5 000)	**1**
Dividends paid	(6 120)	**1**
Balance at the end	**70 095**	

OR
Alternative Presentation

	Ordinary share capital $	Retained earnings $	General reserve $	Asset revaluation reserve $	Total equity $	**Marks**
Balance at 30th June 2016	204 000	76 000	10 000	0	290 000	**4**
Issue of Bonus Shares	20 400 **(3)***			(20 400) **(1)**		**4**
Dividends		(6 120) **(1)**			(6 120)	**1**
Total comprehensive income for the year		5 215 **(2)**		110 000 **(2)**	115 215	**4**
Transfer to general reserve		(5 000) **(1)**	5 000 **(1)**			**2**
Balance at 30th June 2017	224 400	70 095	15 000	89 600	399 095	

(c) On 12 September 2016, at the AGM, the Directors declared a final dividend of 10 cents per share. Prepare the General Journal entry to record the final dividend declared. (6 marks)

Workings:
*Final dividend (102 000 **(1)** + bonus 10 200 **(1)**) x 0.10 **(1)** = $11 400

Fahrrad Ltd
General Journal (extract)

2016 Sept 12	Final dividend declared or Retained Earnings **(1)**	11 400 **(3)***	
	Final dividend payable **(1)**		11 400
	Final dividend of 10 cents per share declared. **(1)**		

(d) State **two** functions of the Financial Reporting Council. (2 marks)

Three functions of the Financial Reporting Council include:
- To provide strategic direction and advice to the Australian Accounting Standards Board (AASB) and government.
- To approve and monitor AASB plans, budgets and staffing.
- To oversee the process for setting accounting and auditing standards in Australia.
- To ensure that Australian accounting and auditing standards remain effective and relevant.
- To oversee the quality of audits conducted by Auditors in Australia.
- Monitors the development of international accounting and auditing standards for world-wide use and promotes their use within Australia.

Students should give three (3) major points each worth one (1) mark
Section Three: Extended response **15% (30 Marks)**

This section contains **two** questions. You must answer **one** question. Write your answers in the space provided.

Question 22 **(30 marks)**

(a) Comment on the trends in profitability, market value and gearing ratios for Hastings Ltd, giving possible reasons for the changes revealed. (9 marks)

The profitability ratios (profit margin and rate of return on assets) of Hastings Ltd, for the past two years 2015 and 2016 have both decreased, showing that the company's profitability has deteriorated. **(1)**

This could be due to a decline in the net profit of the company due to a lower demand in sales or poor control of expenses or higher prices paid for inventory which has not been passed onto customers or that the company's assets are not being used productively due to their age or recent acquisition. **Any two reasonable points (2)**

The market value ratios (earnings per share, dividend yield and price earnings ratio) have all increased showing that the company is performing better. **(1)**

Given that the profitability of the company has declined this positive trend in the market value ratios could be due to the company buying back some of its shares so that the profit is shared amongst less shareholders; an increase in the dividends paid to shareholders which is at a rate greater than the increase in the market share price; and the market share price has increased at a faster rate than the increase in earnings per share. **Any two reasonable points (2)**

The company is less highly geared; ie it has a low dependency on external funds as evidenced by the debt to equity ratio which has declined. **(1)**

This could be because the company has paid off debt; or issued shares; or the company has revalued upwards some of its non-current assets resulting in increased equity.
Any two reasonable points (2)

(b) Identify and describe **three (3)** items included in a company annual report ***other*** than financial statements and notes to the accounts. (6 marks)

Napier Public Accountants confirm that the additional information in the annual report is necessary for full disclosure and must meet certain requirements and these include the following:

The external audit report: This provides an independent opinion on the financial statements. It states whether all information, assistance and explanations have been provided to the auditors for them to make their judgments. It also states whether the financial statements comply with the Corporations Act and Accounting Standards and gives a true and fair view of the company's financial performance position and cash flows.

Director's report: This provides a review of the company's main business objectives, the company's financial position ,any changes to the board of directors, future directions and prospects, business strategies, review of past years operations, and the names of directors and officers of the company and their remuneration.

A corporate governance report: This is required by the ASX for all listed companies. This report encompasses the rules, policies, processes and systems of the entity which must be followed and maintained. This includes the obligations of directors who must act in good faith in the best interest of the company.

A directors' declaration: This states that the financial statements and notes to the accounts give a true and fair view of the company's results, that they have been prepared in accordance with accounting standards and that the company is solvent; ie the company is able to pay its debts as and when they became due and payable.

Corporate social disclosure report: This provides information concerning the company's' corporate social responsibilities and their disclosure as to whether they have achieved their objectives and obligations.

Performance indicators report: This provides details concerning the company's performance against its key performance indicators. These may be financial or non-financial indicators.

Students should outline three (3) items from the above list, explaining each in enough depth to gain two (2) marks each.

(c) State **three (3)** limitations in assessing the company's performance from financial statement analysis. (3 marks)

The limitations of ratio analysis in assessing the performance of a company are:

- Ratios do not provide much information upon which to make a sound financial decision unless they are compared to other businesses, past years or industry averages.
- Ratios are only a guide and do not identify the problem or reason for success. Ratios are a quantitative tool for analysis but fail to identify qualitative aspects of a business's operations which may be the reason for success or failure.
- Ratio analysis is based on financial statements which are a report of past performance and not future performance. Ratios do not have a predictive value.
- Financial statements are published sometime after the end of the financial year so the information upon which the ratios are based can be out of date.
- Financial statements are based on historical cost accounting and it can be questioned as to whether it provides relevant information for assessing the performance of a business as it does not show current asset values; does not account for inflation; and does not determine the present value of assets and liabilities.
- When using market ratios such as the price earnings ratio or dividend yield where the market price of shares is part of the calculation it must be remembered that the market price of shares is influenced by factors (eg. political events) not related to the company's performance.
- It is not always easy to make comparisons between businesses as they may use different accounting practices and policies to determine the amounts shown in financial statements upon which the ratios are based. There may not be adequate disclosure to determine the differences in accounting policies used.
- Ratios are based on financial statements which have sometimes been manipulated to achieve the objectives of the management of the company. This window dressing may give a false impression of the success or weakening of a business.

Students should give three (3) limitations of ratio analysis from the list above. Each limitation is worth one (1) mark.

(d) Explain **three (3)** reasons why Hastings Ltd has engaged in socially and environmentally responsible practices (6 marks)

Reasons why Hastings Ltd has engaged in socially and environmentally responsible practices are to:

- Attract and retain high caliber employees as some look for employment with those businesses which have community links, sound ethical principles, are environmentally conscious or who offer flexible workplace conditions.
- Build relationships with clients, customers and suppliers as they may see the firm as more trustworthy and this can in turn attract business.
- Improve financial performance as being socially and environmentally conscious may reduce resource use, waste and emissions, and therefore reduce business costs.
- Reduce the impact of negative publicity should the firm be involved in an event which affects its reputation.
- Be a very effective marketing tool as it differentiates your business from other similar businesses and therefore makes your firm the business of choice.
- Lead to new business opportunities as the business is more likely to be in touch with customers, clients and the general community.
- Appeal to socially aware investors making it easier to attract investment.
- Assist in ensuring that the business is complying with or delay the demand for more regulatory requirements.

Students should give three (3) reasons why Hastings Ltd has engaged in socially and environmentally responsible practices, explaining each in enough depth to gain two (2) marks each.

(e) Explain **three (3)** ethical issues/dilemmas which may be encountered in financial dealings between business managers and their clients, employees and investors. (6 marks)

Ethical issues/dilemmas which may be encountered in financial dealings between business managers and their clients, employees and investors are:

Conflict of interest
A conflict of interest is when a business owner or manager , accountant, or finance officer does not display objectivity or independence in their decision making because they have competing interests with regards to the decision they are required to make. **(1)** These competing interests are incompatible as they can result in the business owner or employee (manager or accountant or finance officer) or the business itself receiving a gain at the expense of the other party(s) involved. **(1)**

Schemes to avoid or evade taxation
Some businesses and their owner(s) or employees such as a manager or accountant may be tempted to avoid or evade paying the correct GST or business/company income taxation. **(1)** Taxation evasion is the deliberate attempt to reduce taxation payable by illegal means, whereas taxation avoidance is the attempt to use the taxation laws to the advantage of the business so as to reduce the amount of taxation payable by legal means. **(1)**

Manipulation of financial information
Business owners and managers may sometimes wish to increase or decrease the profit of their business for some reason. **(1)** This reason may be to boost their bonus payment to themselves or to advantage the business or make sure it is not disadvantaged in some way. This may for example be done to alter the business's debt to equity ratio and so improve their likelihood of convincing a bank to lend them money. A further example may be to reduce profit so as to make the business not appear to be as successful and so reduce the demand from employees for a salary increase or to reduce the desire of some in the community for more regulation of the industry that the business operates in. **Students should give one example (1)**

Lack of confidentiality of information
A business owner or employee such as a manager or accountant or finance officer is in a position of responsibility and authority, and they often have access to privileged information. **(1)** This information may relate to a customer or employee or client or investor and they should not under any circumstances provide this information to others which would be to the detriment of that person or the business. **(1)**

Use of financial information for personal use
A business owner or employee such as an accountant or finance officer may have access to privileged information which others such as current or potential investors or lenders do not have access to. **(1)** The business owner or employee could use this information to their financial advantage. **(1)**

Using business assets for personal gain
Those in authority in a business such as a manager or accountant or finance officer of a business could use business assets for their own personal use. **(1)** This is a breach of their duty of care and is dishonest. **(1)**

Inducements
Business managers or accountants or finance officers or other employees are sometimes given incentives such as a gift so as to encourage or induce the employee to act in favour of the person (eg, customer or client or investor or lender) giving the gift. Business managers or accountants or finance officers or other employees should not accept such gifts or other incentives. **(1)**

Business owners or their employees may be tempted to provide customers or clients or investors or lenders with a financial incentive such as a gift so as to encourage them to act in the favour of the business. Financial incentives should not be given where the customer or client or investor or lender may consider it an inducement for them to act unfairly in favour of the business. **(1)**

Students should explain any three (3) of the above ethical dilemmas or other appropriate dilemmas, explaining each in enough depth to gain two (2) marks each.

OR

Question 23 **(30 marks)**

(a) Comment on the differences, and possible reasons for the differences, in the liquidity and gearing of Silver Coast Ltd and Gee Long Pty Ltd. (9 marks)

Gee Long Ltd is more highly geared as there is more dependency on external funds evidenced by the Debt to Equity ratio which is higher than that of Silver Coast Ltd. **(1)** In addition the Times Interest Earned ratio indicates that Silver Coast Ltd is in a better position in that it can service its debts (and not default) and has the ability to repay debts such as interest on loans as compared to Gee Long Ltd. **(1)**

The reason for this is possibly that Gee Long Ltd has borrowed more funds to finance business expansion or that Silver Coast Ltd has undertaken to repay its debts or Silver Coast Ltd has increased its equity by retaining more profits within the business, or Silver Coast Ltd may have issued more shares. **Any two reasonable points (2)**

The liquidity of Gee Long Ltd is in a better position than that of Silver Coast Ltd as both the Working Capital ratio and Quick Asset ratio of Gee Long Ltd are higher. **(1)** While Silver Coast Ltd’s ratios show they are able to meet debts, **(1)** the Working Capital ratio and Quick Asset ratio of Silver Coast Ltd are both below the ideal ratio of 1.0:1.0. Anything below 1.0 indicates that it may have some difficulty repaying its debts as they fall due or if it was required to repay its immediate debts owing. **(1)**

The possible reasons for the difference between the two companies is that Gee Long Ltd may have retained more cash or provided more credit sales (and therefore has more Accounts Receivables) or has a slightly lower inventory turnover (and therefore more inventory on hand) as compared to Silver Coast Ltd. Silver Coast Ltd may be experiencing a slowdown in its credit sales (and therefore has less Accounts Receivables) or a poor credit collection policy leading to a lack of cash inflow or is keeping its stock levels to a minimum. **Any two reasonable points (2) (Other appropriate reasons may be given)**

(b) Outline **three (3)** major differences between a public and large proprietary company. (6 marks)

The differences between a public and large proprietary company are:

- A large proprietary company is not required to hold an Annual General Meeting (AGM) unless the company’s constitution requires it to do so whereas a public company must hold an AGM.
- A large proprietary company cannot have more than 50 non-employee shareholders whereas a public company can have an unlimited number of shareholders.
- A large proprietary company is not able to issue a prospectus to raise funds from the general public whereas a public company can do so.
- A large proprietary company can only offer shares to existing shareholders and employees whereas a public company is not restricted in this way.
- A large proprietary company must have the words proprietary limited or initials Pty Ltd at the end of its name whereas a public company must have the words limited or initials Ltd at the end of its name.

- A large proprietary company must have at least one director but does not require a company secretary whereas a public company must have at least three directors and one company secretary.
- A large proprietary company does not need to open its office to the general public but a public company must do so.

Students should give three (3) points from the above or other reasonable explanation, each in enough depth to gain two (2) marks.

(c) Describe **three (3)** duties of a company director as outlined in the Corporations Act 2001. (3 Marks)

The Corporations Act 2001 outlines the following as the duties of a company director:

- **To show responsibility and to exercise due care and diligence** in all business dealings, with internal and external parties, whether it is of a financial, managerial or administrative nature. They must for example appoint competent senior executives to manage the company with established strategies, plans, policies, and procedures and keep themselves up-to-date with the financial position and performance of the company.
- **To carry out their tasks for a proper purpose and act in good faith and in the best interests of the company**. They must for example approve business dealings such as major capital decisions, long-term borrowings, share issues and recommend dividends so as to the benefit of shareholders and the company. Their task is to protect the rights of shareholders and to keep them informed. Directors must at all times display independent judgment in light of relevant facts when making decisions.
- **To not use their position to gain a benefit for themselves or someone else.** For example they must not improperly use company assets for their own purposes or financial advantage or act in any way that would cause harm to the company's reputation. This duty must be carried out even if it is to the directors own disadvantage.
- **To not use information gained to the benefit of themselves or someone else.** All information is gained in confidence and therefore they must not undertake any action that would cause harm to the company. This duty must be carried out even if it is to the directors own disadvantage.
- **To avoid a conflict of interest.** If a director believes there may be a conflict of interest that could bring the company into disrepute they must bring this to the attention of other company board members. Where a conflict of interest may exist a director may need to refrain from voting in these circumstances and in some cases may need to resign.
- **To ensure that the company does not trade if it is insolvent.** Directors must make sure that the company pays its debts on time and be aware of the company's financial position at all times. Failure to do so may result in them being personally liable for the debt and be required to pay compensation to the company or creditors.
- **To maintain and review appropriate financial records** of the company and be able to explain its transactions, financial position and performance. Directors are required for example to review the effectiveness of internal control over assets, ensure the preparation of financial reports and to make arrangement for these financial reports to be audited.

Students should give three (3) points each worth one (1) mark

(d) Explain the function of internal and external audits. (6 marks)

The function of an external audit is to:

- Examine the company's accounting systems and records. This involves the collection of sufficient evidence to determine if the company's internal controls are working as intended, that the financial reports are free of material misstatement and to detect major fraud or collusion.
- Come to a conclusion as to whether the company's financial statements represent a true and fair view of its financial performance and position.
- Ensure that the company is complying with the provisions of the Corporations Act and AASB accounting standards. If a company has not complied with these the auditor must report the company to the Australian Securities and Investments Commission (ASIC).
- Provide external users of financial statements with confidence to make informed judgments based on a company's financial statements and thereby assist the Australian capital markets to operate effectively.
- Evaluate the company's financial status to determine if there is any doubt about its ability to continue to operate as a going concern in the foreseeable future.
- Prepare an audit report to be included in the Annual Report– either qualified or unqualified. A qualified report will be issued where a company has either not complied with the Corporations Act, AASB accounting standards or where there are concerns as to whether the financial reports provide a true and fair view of the company's financial performance and position or there is a concern as to whether the company is a going concern.

Students should give three (3) points from the above or other reasonable explanation each worth one (1) mark.

The function of an internal audit is to:

- Detect and correct of errors so that financial information is accurate and any fraudulent activity is detected.
- Monitor internal controls to see if they are functioning correctly to achieve their purpose and where necessary make improvements and prevent fraud.
- Identify deficiencies in business procedures and processes so that improvements can be made which lead to better efficiency and effectiveness of operation.
- Assist in ensuring good corporate governance so that there is better management and accountability of both financial and non-financial operations.

Students should give three (3) points each worth one (1) mark.

(e) Explain **three (3)** reasons why business planning is important. (6 marks)

Business planning is important for the following reasons:

- To provide direction to the business as planning is about developing a mission statement, objectives and strategies which will give the business purpose, set targets to be achieved and develop a way forward. This will enable the business to anticipate problems, prioritize actions to be taken and reduce the risk of failure.
- To provide a vision for the future of the business. Planning is about foreseeing and adapting to change, developing new initiatives, improving decision making and promoting creativity and innovation.
- To plan for its future financing needs. Business planning includes budgeting such as capital expenditure budgeting and cash budgeting. From these budgets the business can see what finance is needed to operate the business successfully in the short term and long term. It is a necessary component to obtaining finance and reducing costs.
- To communicate a course of action and improves the coordination of the business. A collaborative approach to business operations will lead to a more successful business as staff clearly know what is meant to be achieved. It enables them to ask questions and provide feedback on the plan and this in turn improves business operations.
- To assist with controlling the firms operations. Plans must be compared to what actually takes place and so when plans are not being achieved a course of action can be developed to ensure the business remains on target.
- To assess the performance of staff and providing incentives for greater success.

Students should give three (3) points each in enough depth to gain two (2) marks.