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Example examination questions

Chapter 2: The business environment

Q1 'All businesses should have moral objectives.' In defence of this statement, explain what is meant by moral objectives and why are they important.

A1 Moral objectives refer to social rather than profit-related objectives. It is important that businesses should also have responsibilities to employees, consumers and the general public, because the way they operate could have an impact on the community at large. For example, if a community depends on a particular industry in their area then any change in its policy or objectives could have a significant impact on this community.

Q2 It is claimed that to be successful, businesses must undertake 'financing'; 'investing' and 'operating' activities. Do you agree? Explain your answer by using your local dairy store as an example.

A2 Yes, I agree. The local dairy is involved in operating activity which is the buying and selling of its goods. It may need money to buy goods and/or services and may therefore seek a loan from, say, a bank (this is financing activity). As well, it may have surplus cash from its operating activity which the owner puts in an interest-bearing savings account in a bank (this is investing activity).

Q3 How do the government and the New Zealand Institute of Chartered Accountants (NZICA) influence the business environment? Do you think such influence is necessary? Why?

A3 The government, through a number of Acts, Regulations and Standards (via the External Reporting Board (XRB)), affects how businesses can operate. NZICA provides input in the development of Accounting Standards and its members are involved in a variety of activities in businesses, including ensuring compliance with Standards. Such influences are necessary because they are there to protect the public from unfair practices.

Q4 Discuss the significance of accounting information both within and outside the organisation.

A4 In general, internal accounting information is required to manage a business and external information is required to demonstrate that a business is being managed efficiently and effectively.

Internal: Accounting information is required to manage a business. It enables managers to measure their efficiency and to assess their future actions.

External: Various external stakeholders require accounting information – for example government (for compliance and tax), investors (to see how their investments are doing and/or to decide on their investment strategies), lenders/creditors (to ensure that the organisation is financially sound and that their funds will be repaid).

Q5 Oliver the Oil Developer

Oliver is a very independent-minded person who likes to run things his own way. He is very hard-working, honest and well-organised. He has a science degree, in which he majored in geology with most of his topics relating to oil-field exploration and development. He also worked for several years on oil rigs off the North Sea.

Oliver believes he could make a success with an oil exploration business of his own, although he realises he would have to raise a lot of money to finance it.

Oliver is considering either a sole trader or a company form of business. Advise Oliver which you think is best for him, stating 3 reasons relating to his circumstances.

A5 The company form appears best, as (any 3 of the following or similar relevant answer):

- Oil exploration requires a lot of money, and so a company form would enable him to advertise for shareholders to contribute capital.
- Oliver is very independent-minded and likes to run things his own way; he could structure the company so that he had control over the main decisions.
- Oil exploration is very risky; a company form of business would provide limited liability to Oliver, so if the company failed, he would not have to pay debts above his share investment.

Q6 Delia the Doctor

Delia passed her final exams and qualified as a medical doctor in 1996, and has worked in the Wellington hospital since qualifying, specialising in heart operations. Delia is married with 3 children who are at secondary school.

She has always wanted to have a medical practice in a country area or small town, as she likes the countryside. She is also not interested in doing any more heart operations.

Delia has seen an advert in the medical journal calling for a doctor to join an existing medical practice in a farming town in the Waikato. While she has not had previous experience in small-town medical practices, she is keen to move. The practice has had a turnover of more than \$500,000 a year and is still growing.

Delia is considering either a partnership or a company form of business.

- a Advise Delia which you think is best for her, stating 3 reasons relating to her circumstances.
- b Explain to Delia what GST is, and state 3 responsibilities in regard to GST that she will have if she becomes an owner of the medical practice business.

- A6 a The partnership form appears best, as (any 3 of the following or similar relevant answer):
- She needs the experience and business knowledge of the existing doctor who has practised before, as she has not.
 - She has 3 children, therefore having a partner would mean she could take holidays and time off to be with her children when needed.
 - The partnership form also provides combined resources, which will enable Delia to use the existing doctor's setup and assets.
 - A partnership is less expensive and less complicated to set up than a company.
 - A company form would, however, offer limited liability if there is a risk that patients might sue the practice for bad work.
- b GST is a tax on consumption of goods and services at the rate of 15%. A business has the responsibility to (any 3 of the following):
- register for GST if its annual turnover (sales and income) is over \$60,000 per year
 - choose a GST period – 1, 2 or 6 months, depending on the business's size
 - keep proper accounting and GST records
 - prepare GST returns each period
 - pay GST to the IRD in the month after the end of each GST period, if GST is owing
 - issue proper 'Tax Invoice' GST invoices with the correct details.

Q7 Outline 4 impacts of increasing IT use in an accounting system.

- A7 (Any 4 of the following or similar relevant answer):
- off-site employees
 - growth of inter-employee email communication
 - greater need for IT competence
 - greater need for back-up and security systems
 - greater reliance on other systems' security and abilities
 - greatly increased knowledge base and sharing of information
 - faster retrieval of information.

Q8 Users of accounting information

Smart, Awan & Baxter (text, p. 21) list seven stakeholders who have an interest in accounting information:

- owners and investors
- managers
- creditors and lenders
- employees
- the government
- unions
- the general public.

a Explain the meaning of 'stakeholder'.

b For each of the first five listed stakeholders (i.e. excluding unions and the general public), state:

- a specific decision that the stakeholder would make, that would require accounting information before they made it
- the specific accounting information they would require for that decision
- the financial statement from which they would obtain that required information.

Note: do not use the same type of decision twice.

A8 a Stakeholders are parties affected in some way by the activities of the business (text, p. 320).

b Owners and investors:

- the decision to increase or decrease their investment
- the rate of return on their investment from net profit and owner's equity
- the Balance Sheet.

Managers:

- the decision to continue or discontinue trading in inventory
- gross profit from trading inventory
- the Income Statement.

Creditors and lenders:

- the decision to lend money or not lend money to the business
- the level of debt as a percentage of total funds
- the Balance Sheet.

Employees:

- the decision to continue working with a business entity or not to continue
- the prior year's net profits of the entity
- the (prior year's) Income Statements.

The IRD (government):

- the decision to investigate an entity's GST records
- the size of the GST refundable or payable
- the Balance Sheet.

- Q9 a** Smart, Awan & Baxter (text, chapter 2) outline two types of investor – current and prospective. Briefly describe two general types of information they are interested in, and what they use the information for.
- b** The text (in chapter 2) further outlines three general types of information needs for managers. Briefly describe these three, and how managers would use this information.
- c** Creditors are interested in solvency and security. Briefly define and explain these in relation to creditors' needs.

- A9 a** **Current investors** are interested in information on the past performance and current position of the business.

They use this information to ascertain how well the business has performed, and to try to predict future returns on their investment.

Prospective investors are interested in information on current economic and political conditions, market rumours and similar information, in order to establish a market value for shares.

They use this information to help decide whether to buy shares in a business.

- b** Managers need information on past profits, to evaluate their past decisions and performance, and to decide whether to pay dividends.

Managers need information on past and predicted cash flows, to know if a business can maintain its liquidity, pay its bills, and maintain its creditworthiness.

Managers need large amounts of detailed information on controlling operations, assets, liabilities and employees, to plan future operations.

- c** **Solvency** means the ability of a business to pay its debts as they fall due. Ideally, a creditor would like to be paid in the normal course of the business's operations.

Security means the assets that a business has to cover debts, should the business not be able to pay those debts out of normal operations. If a business cannot pay its debts in the normal course of business, creditors like to know that if the business has to wind up, there will be sufficient money from the sale of its assets to cover the creditors' claims.

- Q10** Choose 3 (three) New Zealand Acts of Parliament that you consider have a major impact on accountants, and 2 (two) examples of that impact.

A10 Financial Reporting Act:

- This act governs the establishment of financial reporting standards in New Zealand.
- It lists the financial statements that must be prepared (by accountants).

Companies Act:

- This act sets financial disclosure requirements for companies in New Zealand.
- It also requires a company's accounting records to be audited where the shareholders of the company request an audit.

GST Act:

- Requires GST to be properly recorded and paid (or refunded) each GST period.
- Requires accountants to keep proper GST records.

Income Tax Act:

- Requires all businesses to pay income tax on their profits.
- Therefore, requires accountants to keep proper records of profits and tax payable.

Q11 Outline 2 major roles of the New Zealand Institute of Chartered Accountants (NZICA) in the accounting profession.

- A11
- i NZICA delivers the professional education and training people need to achieve an NZICA designation, and provides the continuing professional development required to maintain the high standards of those designations.
 - ii NZICA is also an advocate for better tax and commercial laws, especially those that cover the activities of accountants.

Q12 What are 3 major activities that the New Zealand Institute of Chartered Accountants (NZICA) undertakes to control the accounting profession in New Zealand? (Note: this is additional to the notes in Smart, Awan & Baxter.)

- A12
- Sets the requirements for new members to join the institute, in terms of education levels and practical work experience.
 - Sets behavioural requirements for members in terms of their expected performance and ethics in business dealings.
 - Disciplines or expels members who break set behaviour standards.