CIMA FINAL ASSESSMENT

Financial Operations

November 2011

Paper F1

Time allowed

Reading and planning: 20 minutes

Writing: 3 hours

All questions are compulsory and MUST be attempted.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Kaplan Publishing/Kaplan Financial

KAPLAN PUBLISHING

The text in this material and any others made available by any Kaplan Group company does not amount to advice on a particular matter and should not be taken as such. No reliance should be placed on the content as the basis for any investment or other decision or in connection with any advice given to third parties. Please consult your appropriate professional adviser as necessary. Kaplan Publishing Limited and all other Kaplan group companies expressly disclaim all liability to any person in respect of any losses or other claims, whether direct, indirect, incidental, consequential or otherwise arising in relation to the use of such materials.

You May contact QQ:139169828 MSN: q7jw00001@hotmail.com For More Information !

SECTION A

Answer ALL 8 sub-questions in this section

QUESTION 1

1.1 Which of the following statements concerning *IAS 10 Events After the Reporting Period* are correct?

(1) Notes to the financial statements must give details of all material adjusting events reflected in those financial statements.

(2) Notes to the financial statements must give details of all non-adjusting events affecting the users' ability to understand the company's financial position.

(3) Financial statements should not be prepared on a going concern basis if, after the reporting period, the directors decide to liquidate the company.

A All three statements are correct

B (1) and (2)

C (1) and (3)

D (2) and (3) **(2 marks)**

1.2 Larch Ltd purchased an item of plant and machinery costing $250,000 on 1 April 2008, which qualified for 50% capital allowances in the first year, and 20% each year thereafter, on the reducing balance basis.

Larch's policy in respect of plant and machinery is to charge depreciation on a straight line basis over ten years, with no residual value. On 1 April 2010, Larch decided to revalue the item of plant and machinery upwards, from its carrying value, by $120,000.

Assuming there are no other capital transactions in the three year period and a tax rate of 30% throughout, calculate the amount of deferred tax to be shown in Larch's income statement for the year ended 31 March 2011, and the deferred tax provision to be included in its statement of financial position at 31 March 2011. **(3 marks)**

1.3 Which of the following is **NOT** a feature of an overseas subsidiary?

A The subsidiary is a separate company for tax purposes

B The holding company will pay tax on all profits earned by the subsidiary

C The holding company will only pay tax on any dividends received from the subsidiary

D Loss relief is not available for the group **(2 marks)**

1.4 Which of the following shows the meaning of the term GAAP?

A Generally accepted accounting procedures

B General accounting and audit practice

C Generally agreed accounting practices

D Generally accepted accounting practice **(2 marks)**

1.5 Chester has an accounting profit before tax of $243,200 for the year ended 31 July 2011. The accounting profit included non-taxable income from government grants of $48,000 and non-tax allowable expenditure of $25,600 on entertaining expenses. Chester also paid a $40,000 dividend to his shareholders. The tax rates were as follows:

Year to 31 March 2011	20%
Year to 31 March 2012	25%

How much tax is Chester due to pay for the year? **(3 marks)**

1.6 An auditor believes that a client's financial statements are misstated due to an incorrect irrecoverable debt provision. They are unable to persuade the directors to amend the financial statements. The difference is considered material but not pervasive. What type of audit report is the auditor likely to issue?

A An unmodified opinion

B A qualified opinion

C An adverse opinion

D A disclaimer opinion **(2 marks)**

1.7 Birch entered into a five year operating lease to acquire a machine for his new business venture on 1 April 2009. The leasing company has agreed that no payments will be required in the first year and then an annual payment of $5,760pa for the next four years. The machine is expected to have a useful life of six years. What would be shown in Birch's financial statements for the year ended 31 March 2011? **(3 marks)**

1.8 Asco Ltd started a five-year contract to build a new shopping centre on 1 April 2010. The contract had a fixed price of $288 million.

Asco Ltd incurred costs to 31 March 2011 of $51 million on work completed, $19 million on WIP and estimated that a further $100 million would need to be spent to complete the contract.

Asco Ltd uses the percentage of cost incurred to date for work completed to total cost method to calculate stage of completion of the contract.

Show the extracts that would be shown in Asco Ltd's income statement and statement of financial position for the year ended 31 March 2011 in relation to this contract. Clearly stating any assets or liabilities. **(3 marks)**

(Total: 20 marks)

SECTION B

Answer ALL six sub-questions in this section

QUESTION 2

(a) You work for a training company and your firm has decided to launch a new marketing campaign with the aim of increasing the number of students and fee income. The managers have asked for suggestions from employees for ways of gaining new students.

Some of the suggestions from employees are set out below:

- Point out how much lower our fees are and how we provide a much better service compared to similar training organisations.
- Offer a 25% discount for the first year of training to new students.
- Offer a commission to all staff for any new students introduced to the organisation.
- When new employees join the organisation from other training organisations, give them an extra incentive to bring students from their old organisation with them.
- Offer a free introductory course for every potential student.
- Offer commission to existing students for introducing new students.

Briefly comment on the appropriateness of these suggestions in relation to professional ethics. **(5 marks)**

(b) Selected balances in Jimbo's financial records at 30 April 2011 were as follows:

	$000
Revenue	24,000
Profit	2,400
Property, plant and equipment – carrying value	33,800
Inventory	2,400

After completing the required audit work the external auditors of Jimbo made the following observations:

(1) Inventory includes a product range which has been included at cost, amounting to $1,000,000. At 30 April these items were expected to sell at $1,500,000 but have since been damaged in warehouse and consequently valued at $600,000.

(2) Development expenditure net book value $960,000, relating to the development of a new product line, had been capitalised and amortised in previous years but the project has now been abandoned.

(3) Decommissioning costs relating to Jimbo's production facilities, estimated to be $8,000,000 in 20 years' time is being provided for, over 20 years, at $400,000 a year.

Assume there are no other material matters outstanding.

At the meeting with the external auditors Jimbo's management decided the following:

- Item (1) the inventory damage occurred after the year-end, so it is not necessary to write off the obsolete inventory until next year.
- Item (2) the development expenditure should continue to be amortised on the statement of financial position until the carrying value is zero.
- Item (3) the decommissioning cost will continue to be provided for over 20 years.

Required:

(i) Explain whether or not the management's decisions taken in the meeting are correct for items (1) to (3).

(ii) Explain the type of audit report that should be issued, giving your reasons.

(5 marks)

(c) Country Dale has the following tax regulations in force:

- The tax year is 1 April to 31 March.
- All corporate profits are taxed at 30% for the tax year 1 April 2009 to 31 March 2010.
- All corporate profits are taxed at 28% for the tax year 1 April 2010 to 31 March 2011.
- When calculating corporate taxable income, depreciation of non-current assets and entertaining expenses cannot be charged against taxable income.
- Tax depreciation is allowed at the following rates:
  - buildings at 3% per annum on straight line basis;
  - all other non-current tangible assets are allowed tax depreciation at 20% per annum on a reducing balance basis.

Emmer Ltd commenced trading on 1 January 2009 when it purchased all its non-current assets.

Emmer's non-current asset purchases were as follows:

	Cost 1 January 2009
	$
Land	32,000
Buildings	128,000
Plant and equipment	33,600
Fixtures	20,000

All buildings are depreciated at 4% on a straight line basis and plant and equipment and fixtures at 25% on a reducing balance basis. The company has a depreciation policy that does not depreciate assets in the year of disposal.

On 1 January 2010, Emmer Ltd disposed of the plant and equipment purchased on 1 January 2009 for $12,000 and purchased new plant and equipment for $50,000. The new plant and equipment qualified for a first year tax allowance of 50%.

You May contact QQ:139169828 MSN: q7jw00001@hotmail.com For More Information !

Emmer's Income statement for the year ended 31 December 2010:

	$
Revenue	600,000
Cost of sales	(264,000)
Gross profit	336,000
Administrative expenses	(182,400)
Distribution costs	(30,000)
	123,600
Finance cost	(7,000)
Profit before tax	116,600

All depreciation on non-current assets has been included in the administration expenses and the gain/loss on disposal of the plant and equipment has been included in the cost of sales.

Administration expenses include entertaining costs totalling $10,000.

Required:

Calculate Emmer Ltd's corporate income tax due for the year ended 31 December 2010. **(5 marks)**

(d) A consumption tax is collected by the businesses that sells products or services subject to tax. Businesses are liable to the tax authorities for the sales tax on their outputs and may be able to claim a credit for sales tax paid on their inputs.

Required:

Explain the difference between a single stage and multi stage system and explain how the system differs when the products or services sold by a business are zero rated or exempt from tax. **(5 marks)**

(e) The following data is to be used to answer question 2e and 2f.

The financial statements of Weatherfield Ltd for the year to 31 October 2011 were as follows:

Statement of financial positions at	*31 October 2011*		*31 October 2010*	
	$000	$000	$000	$000
Assets				
Non-current tangible assets				
PPE		19,266		15,299
Current assets				
Inventory	1,567		1,480	
Trade receivables	540		356	
Cash and cash equivalents	680		352	
		2,787		2,188
Total assets		22,053		17,487
Equity and liabilities				
Ordinary shares $1	6,000		5,000	
Share premium	1,750		600	
Revaluation reserve	1,560		–	
Retained earnings	9,248		8,089	
		18,558		13,689
Non-current liabilities				
Interest bearing borrowings	500		450	
		500		450
Current liabilities				
Trade and other payables	1,545		1,678	
Tax payable	1,450		1,670	
		2,995		3,348
		22,053		17,487

Income statement for the year to 31 October 2011

	$000	$000
Revenue		18,050
Cost of sales		(10,000)
Gross profit		8,050
Administrative expenses	(2,500)	
Distribution costs	(2,162)	(4,662)
		3,388
Finance cost		(32)
Profit before tax		3,356
Income tax expense		(1,569)
Profit for the period		1,787

Additional information:

1 Trade and other payables comprise:

	31 October 2011	*31 October 2010*
	$000	$000
Trade payables	1,540	1,674
Interest payable	5	4
	1,545	1,678

2 Plant disposed of in the year had a carrying value of $1,356,000 for a profit of $200,000.

3 Weatherfields's income statement includes depreciation for the year of $3,560,000.

4 During the year, Weatherfield made a 1 for 10 bonus issue of shares.

5 The statement of changes in equity for the year showed a transfer from the revaluation reserve to retained earnings of $270,000.

Required:

Using the data relating to Weatherfield above, calculate the cash generated from operations that would appear in Weatherfield's Statement of cash flows, using the

indirect method, for the year ended 31 October 2011, in accordance with *IAS 7 Statement of cash flows*. **(5 marks)**

(f) **Required:**

Using the data relating to Weatherfield above, calculate the cash flow from investing activities and cash flows from financing activities sections of Weatherfield's Statement of cash flows for the year ended 31 October 2011, in accordance with *IAS 7 Statement of cash flows*. **(5 marks)**

(Total: 30 marks)

SECTION C

Answer both questions in this section

QUESTION 3

Performance Ltd produces two different products ranges, dance costumes and shoes and stage scenery. In recent years the stage scenery has been losing its popularity and sales have made a sharp decline. By the end of December 2009 it was decided that they must cease production and provisions were made for $160,000 closure costs and all assets relating to the product range were put up for sale.

The following trial balance relates to Performance Ltd 31 March 2010:

	$000s	$000s
7% Debenture Loan (redeemable July 2010)		2,600
Administration expenses –Dance product range	187	
Administration expenses –Scenery product range	34	
Distribution costs – Dance product range	92	
Distribution costs – Scenery product range	12	
Lease rentals (note 1)	20	
Loan interest paid	91	
Land at revaluation (note 2)	1,500	
Property cost (note 2)	2,500	
Plant at cost	1,706	
Depreciation 1 April 2009 – plant and equipment		415
Depreciation 1 April 2009 – property		860
Brand name – Scenery product range (note 2)	250	
Provision for amortisation on brand name		78
Provision for closure costs		160
Closure costs	200	
Purchases – Dance product range	513	
Purchases – Scenery product range	127	
Inventory 1 April 2009 – Dance product range	100	
Inventory 1 April 2009 – Scenery product range	86	
Cash received on disposal of building and land (note 2)		2,100
Cash received on disposal of plant (note 2)		150
Trade receivables	140	
Cash and cash equivalents	3,192	
Trade payables		90
Taxation – under-provision in year to 31 March 2009	40	
Equity shares of 50c each		1,500
Share premium		200
Revenue – Dance product range		1,262
Revenue – Scenery product range		42
Retained earnings 1 April 2009		230
Revaluation Reserve 1 April 2009		900
Deferred tax provision 1 April 2009		203
	10,790	10,790

The following notes are relevant:

(1) A lease rental of $20,000 was paid on 31st March 2010. It is the first of five annual payments in arrears for the rental of an item of equipment that was purchased on 1st April 2009 and had a cash purchase price of $80,000. The auditors have advised that this is a finance lease and that finance costs should be calculated using the sum of the digits method. Leased assets should be depreciated on a straight-line basis over the life of the lease. No entries have been made for this lease except for the cash paid.

(2) During the year assets relating to the Product Scenery range were sold as follows:

- The land and buildings were sold during the year for $2,100,000
- The plant and machinery was sold for $150,000.
- All cash received has been included on the trial balance.
- The purchased brand name was considered to have no value and should be written off.

The book value of assets sold was as follows:

- Land cost $300,000, had been revalued to $850,000.
- Buildings cost $400,000, accumulated depreciation $220,000.
- Plant and machinery, cost $462,000, accumulative depreciation $195,000.

After the above disposals the remaining buildings were revalued to $2,400,000.

An item of plant and machinery is also currently up for sale and although a buyer is interested, a sale was not completed at the reporting date. This item cost $300,000, has accumulated depreciation of $180,000 and was advertised for sale at $125,000. Costs to sell are expected to be in the region of $8,000.

(3) Buildings are depreciated at 5% per annum on a straight line basis and charged 80% to cost of sales and 20% to administration expenses. Plant and machinery is depreciated at 25% reducing balance basis and charged to cost of sales. Performance Ltd has an accounting policy where it charges full depreciation in the year of purchase and none in the year of disposal.

(4) There were no purchases of tangible non-current assets during the year.

(5) A provision for income tax for the year to 31 March 2010 of $113,000 is required and the deferred tax provision should be reduced to $170,000.

(6) The company has paid half of the annual debenture interest.

(7) Closing inventory of the Dance product range was valued at a cost of $65,500. An inspection of finished goods inventory found that a production machine had been set up incorrectly and several production batches, which had cost $5,000 to manufacture had the wrong packaging. The goods cannot be sold in this condition, but could be repackaged at an additional cost of $2,000. They could then be sold for $5,500. There was no closing inventory of the Scenery product range.

(8) During the year a rights issue had taken place of 100,000 50c equity shares for $1.20. All rights were taken up and all amounts are included in the trial balance.

(9) No dividends were paid in the year to shareholders.

Required:

Prepare the Statement of comprehensive income for Performance Ltd, a statement of changes in equity for the year to 31 March 2010, and a statement of financial position as at that date.

Notes to the financial statements are NOT required, but all workings must be clearly shown.

(Total: 30 marks)

QUESTION 4

The statements of financial position of Kanga and its investee companies Tigga and Pooh at 31 December 2009 are given below:

Statements of financial position at 31 December 2009

	Kanga		**Tigga**		**Pooh**	
	$000	$000	$000	$000	$000	$000
Non-current assets						
Property, plant and equipment		5,120		3,712		3,024
Investments		5,280		–		–
		10,400		3,712		3,024
Current assets						
Inventories	1,024		624		600	
Receivables	560		544		568	
Cash and cash equivalents	240		192		64	
		1,824		1,360		1,232
		12,224		5,072		4,256
Equity						
Share capital ($1 ordinary shares)		4,800		1,600		1,600
Reserves		5,520		2,360		1,640
		10,320		3,960		3,240
Non-current liabilities						
6% Loan note		960		480		160
Current liabilities						
Trade payables	480		320		448	
Taxation	464		312		408	
		944		632		856
		12,224		5,072		4,256

Additional information

(i) Kanga acquired 1,600,000 ordinary shares in Tigga on 1 January 2008 for $4,160,000 when the reserves of Tigga were $1,280,000.

(ii) At the date of acquisition of Tigga, the fair value of its property, plant and equipment was $800,000 higher than its book value. The estimated future useful economic life of the property, plant and equipment of Tigga at 1 January 2008 was 5 years.

(iii) Kanga acquired 480,000 ordinary shares in Pooh on 1 January 2008 for $1,120,000 when the reserves of Pooh were $970,000.

(iv) Kanga manufactures a component used by both Tigga and Pooh. Kanga sells this component at a mark up of 40% on cost. Tigga held $448,000 inventories of these components at 31 December 2009 and Pooh held $350,000 at the same date.

(v) The receivables of Kanga include $192,000 in respect of amounts owing by Tigga and $160,000 in respect of amounts owing by Pooh. The corresponding balances in the payables of Tigga and Pooh are $128,000 (Tigga) and $160,000 (Pooh). On 31 December 2009 Tigga made a payment of $64,000 to Kanga that was recorded by Kanga on 6 January 2010.

(vi) The impairment test on goodwill of Tigga is impaired by 20% at 31 December 2009. There has been no impairment on the goodwill for Pooh.

Required:

Prepare the consolidated statement of financial position of the Kanga group at 31 December 2009.

(Total: 20 marks)