CIMA INTERIM ASSESSMENT

Financial Management

November 2011

Paper F2

Time allowed

Reading and planning: 20 minutes

Writing: 3 hours

All SEVEN questions are compulsory and MUST be attempted.

Maths tables and formulae are on pages 3 – 7

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.

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FORMULAE AND TABLES

Present value table

Present value of \$1 i.e. that is $(1 - r)^{-n}$ where r = interest rate; n = number of periods until payment or receipt.

Periods	Interest rates (*r*)									
(*n*)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621
6	0.942	0.888	0.837	0.790	0.746	0705	0.666	0.630	0.596	0.564
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239
16	0.853	0.728	0.623	0.534	0.458	0.394	0.339	0.292	0.252	0.218
17	0.844	0.714	0.605	0.513	0.436	0.371	0.317	0.270	0.231	0.198
18	0.836	0.700	0.587	0.494	0.416	0.350	0.296	0.250	0.212	0.180
19	0.828	0.686	0.570	0.475	0.396	0.331	0.277	0.232	0.194	0.164
20	0.820	0.673	0.554	0.456	0.377	0.312	0.258	0.215	0.178	0.149

Periods (*n*)	Interest rates (*r*)									
	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.079	0.065
16	0.188	0.163	0.141	0.123	0.107	0.093	0.081	0.071	0.062	0.054
17	0.170	0.146	0.125	0.108	0.093	0.080	0.069	0.060	0.052	0.045
18	0.153	0.130	0.111	0.095	0.081	0.069	0.059	0.051	0.044	0.038
19	0.138	0.116	0.098	0.083	0.070	0.060	0.051	0.043	0.037	0.031
20	0.124	0.104	0.087	0.073	0.061	0.051	0.043	0.037	0.031	0.026

Cumulative present value of $1

This table shows the Present Value of $1 per annum, Receivable or Payable at the end of each year for *n* years $\frac{1-(1+r)^{-n}}{r}$

Periods (*n*)	Interest rates (*r*)									
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	1.970	1.942	1.913	1.886	1.859	1.833	1.808	1.783	1.759	1.736
3	2.941	2.884	2.829	2.775	2.723	2.673	2.624	2.577	2.531	2.487
4	3.902	3.808	3.717	3.630	3.546	3.465	3.387	3.312	3.240	3.170
5	4.853	4.713	4.580	4.452	4.329	4.212	4.100	3.993	3.890	3.791
6	5.795	5.601	5.417	5.242	5.076	4.917	4.767	4.623	4.486	4.355
7	6.728	6.472	6.230	6.002	5.786	5.582	5.389	5.206	5.033	4.868
8	7.652	7.325	7.020	6.733	6.463	6.210	5.971	5.747	5.535	5.335
9	8.566	8.162	7.786	7.435	7.108	6.802	6.515	6.247	5.995	5.759
10	9.471	8.983	8.530	8.111	7.722	7.360	7.024	6.710	6.418	6.145
11	10.368	9.787	9.253	8.760	8.306	7.887	7.499	7.139	6.805	6.495
12	11.255	10.575	9.954	9.385	8.863	8.384	7.943	7.536	7.161	6.814
13	12.134	11.348	10.635	9.986	9.394	8.853	8.358	7.904	7.487	7.103
14	13.004	12.106	11.296	10.563	9.899	9.295	8.745	8.244	7.786	7.367
15	13.865	12.849	11.938	11.118	10.380	9.712	9.108	8.559	8.061	7.606
16	14.718	13.578	12.561	11.652	10.838	10.106	9.447	8.851	8.313	7.824
17	15.562	14.292	13.166	12.166	11.274	10.477	9.763	9.122	8.544	8.022
18	16.398	14.992	13.754	12.659	11.690	10.828	10.059	9.372	8.756	8.201
19	17.226	15.679	14.324	13.134	12.085	11.158	10.336	9.604	8.950	8.365
20	18.046	16.351	14.878	13.590	12.462	11.470	10.594	9.818	9.129	8.514

Periods	Interest rates (*r*)									
(*n*)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	1.713	1.690	1.668	1.647	1.626	1.605	1.585	1.566	1.547	1.528
3	2.444	2.402	2.361	2.322	2.283	2.246	2.210	2.174	2.140	2.106
4	3.102	3.037	2.974	2.914	2.855	2.798	2.743	2.690	2.639	2.589
5	3.696	3.605	3.517	3.433	3.352	3.274	3.199	3.127	3.058	2.991
6	4.231	4.111	3.998	3.889	3.784	3.685	3.589	3.498	3.410	3.326
7	4.712	4.564	4.423	4.288	4.160	4.039	3.922	3.812	3.706	3.605
8	5.146	4.968	4.799	4.639	4.487	4.344	4.207	4.078	3.954	3.837
9	5.537	5.328	5.132	4.946	4.772	4.607	4.451	4.303	4.163	4.031
10	5.889	5.650	5.426	5.216	5.019	4.833	4.659	4.494	4.339	4.192
11	6.207	5.938	5.687	5.453	5.234	5.029	4.836	4.656	4.486	4.327
12	6.492	6.194	5.918	5.660	5.421	5.197	4.988	7.793	4.611	4.439
13	6.750	6.424	6.122	5.842	5.583	5.342	5.118	4.910	4.715	4.533
14	6.982	6.628	6.302	6.002	5.724	5.468	5.229	5.008	4.802	4.611
15	7.191	6.811	6.462	6.142	5.847	5.575	5.324	5.092	4.876	4.675
16	7.379	6.974	6.604	6.265	5.954	5.668	5.405	5.162	4.938	4.730
17	7.549	7.120	6.729	6.373	6.047	5.749	5.475	5.222	4.990	4.775
18	7.702	7.250	6.840	6.467	6.128	5.818	5.534	5.273	5.033	4.812
19	7.839	7.366	6.938	6.550	6.198	5.877	5.584	5.316	5.070	4.843
20	7.963	7.469	7.025	6.623	6.259	5.929	5.628	5.353	5.101	4.870

Formulae

Annuity

Present value of an annuity of $1 per annum receivable or payable for *n* years, commencing in one year, discounted at *r*% per annum:

$$PV = \frac{1}{r}\left[1 - \frac{1}{[1+r]^n}\right]$$

Perpetuity

Present value of $1 per annum, payable or receivable in perpetuity, commencing in one year, discounted at *r*% per annum:

$$PV = \frac{1}{r}$$

Growing perpetuity

Present value of $1 per annum, receivable or payable, commencing in one year, growing in perpetuity at a constant rate of *g*% per annum, discounted at *r*% per annum:

$$PV = \frac{1}{r - g}$$

SECTION A

ALL FIVE questions are compulsory and MUST be attempted

QUESTION 1

Hilde purchased 75% of the issued share capital of Sylvia and 40% of the issued share capital of Almena on 1 April 20X4. The summarised income statements for the three companies for the year to 30 September 20X4 are given below:

	Hilde	*Sylvia*	*Almena*
	$000	$000	$000
Revenue	75,000	40,700	31,000
Cost of sales	(47,400)	(19,700)	(15,300)
Gross profit	27,600	21,000	15,700
Operating expenses	(10,480)	(9,000)	(9,700)
Profit from operations	17,120	12,000	6,000
Finance costs	(170)	–	–
Profit before tax	16,950	12,000	6,000
Income tax expense	(4,800)	(3,000)	(2,000)
Profit for year	12,150	9,000	4,000

The following information is relevant:

1 A fair value exercise was carried out for Sylvia at the date of its acquisition, and it was discovered that plant with a carrying value of $25 million had a fair value of $30 million. The remaining life of the plant as at acquisition was five years. Depreciation on plant is charged to cost of sales. The fair values of Almena's net assets at acquisition were equal to their carrying values.

2 In the post-acquisition period, Hilde sold goods to Sylvia for $10 million. Hilde made a profit of $4 million on these sales. One-quarter of these goods were still in the inventory of Sylvia at 30 September 20X4.

3 In the post-acquisition period, Almena sold goods to Hilde for $2 million at a mark-up of 25%. All of these goods were still in the inventory of Hilde at 30 September 20X4.

4 Impairment tests were carried out at 30 September 20X4 and this resulted in the need to write down the goodwill in Sylvia by $750,000. There was no impairment relating to the investment in Almena. It is group policy to value NCI at the proportion of the fair value of net assets at acquisition.

Required:

Prepare a consolidated income statement for the Hilde group for the year ended 30 September 20X4. **(10 marks)**

QUESTION 2

The Lever group hold 25% of the issued ordinary shares of Arch. Lever have entered into a contractual arrangement with the other shareholders of Arch such that no one shareholder can unilaterally control the economic activities of Arch. However, a director of Lever has been appointed as managing director of Arch and is responsible for implementing financial and operating policies.

The summarised statements of financial position of Lever and Arch as at 30 April 20X5 are given below:

	Lever	*Arch*
	\$000	\$000
Non-current assets	12,000	3,000
Investment in Arch at cost	900	
Current assets	4,100	1,300
	17,000	4,300
Equity		
Share capital	10,000	2,500
Retained earnings	1,800	700
Non-current liabilities	1,400	200
Current liabilities	3,800	900
	17,000	4,300

The shareholding in Arch was acquired on 1 May 20X4 when the retained earnings of Arch were \$600,000.

The directors of Lever are unsure how to treat their investment in Arch in their consolidated financial statements for the year ending 30 April 20X5.

Required:

(a) **Briefly explain the potential ways in which the investment in Arch could be classified in the consolidated financial statements of Lever for the year ended 30 April 20X5. Explain how you believe the investment should be accounted for based on the information provided. (6 marks)**

(b) **Prepare a summarised consolidated statement of financial position as at 30 April 20X5 for the Lever group, using the proportionate consolidation method to account for the investment in Arch. (4 marks)**

(Total: 10 marks)

QUESTION 3

At 1 July 20X4, MP owned 75% of the 2,000,000 ordinary shares of its subsidiary, TR. Summarised income statements of both entities for the year ended 30 June 20X5 are shown below:

	MP	*TR*
	$000	$000
Revenue	10,000	3,000
Operating costs	(8,000)	(2,300)
Profit before tax	2,000	700
Income tax expense	(450)	(200)
Profit for the year	1,550	500

MP purchased 1,500,000 of TR's $1 shares in 20X2 for $4 million, when TR's reserves were $2.5 million. Goodwill has been carried at cost since acquisition and there has been no subsequent impairment.

On 1 January 20X5, MP disposed of 600,000 shares in TR for $2.6 million. TR's reserves at 1 July 20X4 were $4.05 million and its profits accrued evenly throughout the year. MP is liable to income tax at 30% on any accounting profits made on the disposal of investments. The fair value of the retained interest in TR is $2.9 million and enabled MP to exercise significant influence.

The effects of the disposal are not reflected in the income statements shown above.

MP values NCI at acquisition using the proportion net assets method.

Required:

Prepare the summarised consolidated income statement for MP for the year ended 30 June 20X5. (10 marks)

QUESTION 4

Mrs Wilson is interested in making an investment. She has obtained the following information from Woodrow for the year ended 30 September 20X8.

	20X8	20X7
	$million	$million
Profit before tax	55	33
Income tax expense	(5)	(3)
Profit for the period	50	30

At 1 October 20X7, there were 260 million ordinary shares in issue. On 1 January 20X8 Woodrow made a bonus issue of one new $1 share for every four held.

In 20X6 Woodrow issued $200 million convertible bonds. The loan stock is convertible to ordinary shares in December 20X8 on the basis of 70 new shares for each $100 of loan stock.

The interest expense relating to the liability element of the bonds for the year ended 30 September 20X8 was $17.2 million (20X7 – $14.9 million). The tax effect related to the interest expense was $1.9 million (20X7 – $1·5 million).

There are directors' share options (in issue since 20X1) that allow Woodrow's directors to subscribe for a total of 50 million new ordinary shares at a price of $1.50 each.

The average market price of Woodrow's ordinary shares throughout the year has been $2.50.

Mrs Wilson has read that the trend of the earnings per share is a reliable measure of a company's profit trend so she is keen to calculate this before she decides whether to invest. She also wishes to understand the relevance of the diluted earnings per share figure.

Required:

(i) Briefly analyse whether the trend of earnings per share is a reliable measure of performance and explain the relevance of the diluted earnings per share figure.
(3 marks)

(ii) Calculate the basic and diluted earnings per share for Woodrow for the year ended 30 September 20X8, including comparatives. (7 marks)

(Total: 10 marks)

QUESTION 5

The draft statements of financial position at 31 March 20X5 of Payne and its 80% subsidiary Glass, acquired on 30 September 20X4, are as follows:

	Payne	*Glass*
	$000	$000
Non-current tangible assets		
Property, plant and equipment	3,038	1,027
Investments	290	
Current assets	2,766	958
	6,094	1,985
Share capitals and reserves		
Ordinary $1 shares	2,000	700
Retained earnings	2,380	765
	4,380	1,465
Liabilities	1,714	520
	6,094	1,985

1 At the acquisition date the statement of financial position of Glass showed net assets with a carrying amount of £1,265,000. Included in this total were freehold land with a carrying amount of £250,000 (market value £683,000). The fair values of all other assets and liabilities are approximately equal to their carrying amounts.

A contingent liability at this date (which was not provided for in the financial statements of Glass) was disclosed as a potential £300,000. However, its fair value was assessed at £58,000. A final decision on this matter is expected to be reached by the end of 20X5.

2 At the acquisition date the directors of Payne plc intended to restructure and reorganise Glass Ltd and wished to provide for restructuring costs which are forecast as £78,000.

3 The consideration for the acquisition comprised cash of $290,000 and 800,000 shares with a nominal value of $1 and fair value of 130c each. The issue of shares has not yet been reflected in the books of Payne.

4 The fair value of the non-controlling interest in Glass at acquisition was $450,000. Payne uses fair value to measure non-controlling interests.

5 Goodwill is not impaired at the year end.

Required:

(a) Calculate the value of the goodwill arising on the acquisition of Glass Ltd in accordance with IFRS 3 (revised) Business Combinations. (3 marks)

(b) Prepare the consolidated statement of financial position for Payne plc as at 31 March 20X5. (7 marks)

(Total: 10 marks)

SECTION B

BOTH questions are compulsory and MUST be attempted

QUESTION 6

The Europe Group expanded its operations by the acquisition of shares in Monaco in 20X1 and in Kenco in 20X3. Financial statements for all companies are made up to 31 December.

The draft income statements for Europe, Monaco and Kenco for the year ended 31 December 20X6 are as follows:

	Europe	*Monaco*	*Kenco*
	$000	$000	$000
Revenue	91,200	49,400	45,600
Cost of sales	(36,100)	(10,926)	(10,640)
Gross profit	55,100	38,474	34,960
Operating expenses	(13,600)	(6,174)	(7,600)
Profit from operations	41,500	32,300	27,360
Interest paid	(650)	–	–
Profit before tax	40,850	32,300	27,360
Tax	(16,600)	(10,780)	(8,482)
Net profit for year	24,250	21,520	18,878
Dividends – declared	(19,000)	–	–
Retained earnings at 31 December 20X5	40,026	26,630	20,918

The draft statements of financial position as at 31 December 20X6 are as follows:

	Europe	*Monaco*	*Kenco*
	$000	$000	$000
Non-current tangible assets (NBV)	70,966	48,546	26,126
Investments			
Shares in Monaco	13,300		
Shares in Kenco		7,600	
Current assets	3,136	18,050	17,766
	87,402	74,196	43,892

Share capitals and reserves			
Ordinary $1 shares	16,000	6,000	4,000
Retained earnings	45,276	48,150	39,796
	61,276	54,150	43,796
Current liabilities	26,126	20,046	96
	87,402	74,196	43,892

The following information is available relating to Europe, Monaco and Kenco:

(1) On 1 January 20X1, Europe acquired 5,400,000 $1 ordinary shares in Monaco for $13,300,000, at which date there was a credit balance on the retained earnings of Monaco of $2,850,000. No shares have been issued by Monaco since Europe acquired its interest.

(2) On 1 January 20X3, Monaco acquired 3,200,000 $1 ordinary shares in Kenco for $7,600,000, at which date there was a credit balance on the retained earnings of Kenco of $1,900,000. No shares have been issued by Kenco since Monaco acquired its interest.

(3) During 20X6, Kenco had made inter-company sales to Monaco of $960,000 making a profit of 25% on cost, and $150,000 of these goods were in inventory at 31 December 20X6.

(4) During 20X6, Monaco had made inter-company sales to Europe of $520,000 making a profit of 33⅓% on cost, and $120,000 of these goods were in inventory at 31 December 20X6.

(5) On 1 November 20X6, Europe sold equipment from inventory to Monaco for $480,000. Monaco has included this equipment in its non-current assets. The equipment had been purchased on credit by Europe for $400,000 in October 20X6 and this amount is included in its current liabilities as at 31 December 20X6.

(6) Monaco charges depreciation on its equipment at 20% on cost. It is company policy to charge a full year's depreciation in the year of acquisition, to be included in the cost of sales.

(7) Europe has a policy of recording non-controlling interests at their proportionate share of net assets.

Required:

(a) Prepare a consolidated income statement for the Europe Group for the year ended 31 December 20X6. (14 marks)

(b) Prepare a consolidated statement of financial position as at 31 December 20X6. (11 marks)

(Total: 25 marks)

QUESTION 7

Hillside is a listed parent of a diverse group of companies operating in several different business sectors. The group prepares consolidated financial statements in accordance with International Accounting Standards.

The group's operations, management structure, and internal financial reporting are organised into operating segments in accordance with IFRS 8 Operating Segments. The directors of Hillside have recently announced their intention to dispose of the chemicals division. A purchaser is currently being sought.

An investor in Hillside has approached you to analyse and explain the key performance and efficiency aspects of the financial statements for the years ended 31 March 20X4 and 20X3, and the investment potential for the future. She has provided you with the following extracts from the financial statements and some additional information.

Income statement

	Year ended 31 March 20X4 $000	Year ended 31 March 20X3 $000
Revenue	37,510	36,260
Cost of sales	(18,090)	(21,440)
Gross profit	19,420	14,820
Operating expenses	(6,730)	(6,200)
Profit from operations	12,690	8,620
Finance costs	(4,660)	(3,670)
Profit before tax	8,030	4,950
Tax	(2,010)	(1,760)
Net profit for the period	6,020	3,190

Additional information

	20X4	20X3
Gearing	39.1%	46.4%
Net asset turnover	1.46 times	1.68 times
Dividend per share	18c	20c
Earnings per share	60.2c	31.9c
Market share price	720c	670c
Return on capital employed	35.7%	27.3%
Average number of employees	1,250	1,100

There have been no changes in share capital during either year.

Segment information

The investor has provided you with the following summary information that she has extracted from the financial statements. She has informed you that the chemicals division originated all the inter-company sales.

	Year ended 31 March 20X4 $000	Year ended 31 March 20X3 $000
Segment revenue		
Electronics	22,340	20,030
Leisure	5,020	5,090
Chemicals	10,810	12,080
Less Inter-segment sales	(660)	(940)
	37,510	36,260
Segment profit from operations		
Electronics	9,200	6,990
Leisure	1,850	1,110
Chemicals	1,640	520
	12,690	8,620
Segment operating profit margin		
Electronics	41.2%	34.9%
Leisure	36.9%	21.8%
Chemicals	15.2%	4.3%
Segment capital expenditure		
Electronics	4,250	5,660
Leisure	360	410
Chemicals	20	150
	4,630	6,220
Segment depreciation expense		
Electronics	1,980	1,760
Leisure	400	360
Chemicals	1,420	1,400
	3,800	3,520

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Segment capital employed		
Electronics	22,750	18,450
Leisure	5,690	4,240
Chemicals	7,120	8,850
	35,560	31,540

Segment return on capital employed		
Electronics	40.4%	37.9%
Leisure	32.5%	26.2%
Chemicals	23.0%	5.9%

Extract from accounting policies note

Segment reporting

The results of business segments have been presented on a management reporting basis. They include all revenues and expenses which are directly attributable to a segment, plus central overhead and finance costs which are allocated by management on a reasonable basis. Management determines transfer prices on sales between segments in a market-orientated manner.

Segment assets and liabilities include all items that are directly attributable to a segment, plus central assets, taxation and interest-bearing liabilities that are allocated on a reasonable basis by management.

Required:

(a) **Write a report to the investor commenting on the performance, efficiency, and investor ratios of the group, calculating five additional relevant ratios to assist in your analysis. Your answer should identify matters that you consider require further investigation.** **(20 marks)**

(b) **Comment on the usefulness of segment reporting in the performance appraisal by investors.** **(5 marks)**

(Total: 25 marks)

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