CIMA

Pillar F

F2 – Financial Management

Specimen Examination Paper

Instructions to candidates

You are allowed three hours to answer this question paper.
You are allowed 20 minutes reading time **before the examination begins** during which you should read the question paper and, if you wish, highlight and/or make notes on the question paper. However, you will **not** be allowed, **under any circumstances**, to open the answer book and start writing or use your calculator during this reading time.
You are strongly advised to carefully read ALL the question requirements before attempting the question concerned (that is all parts and/or sub-questions). The requirements for all questions are contained in a dotted box
ALL answers must be written in the answer book. Answers or notes written on the question paper will **not** be submitted for marking.
Answer the FIVE compulsory questions in Section A on pages 2 to 7.
Answer the TWO compulsory questions in Section B on pages 8 to 11.
Maths Tables are provided on pages 12 to 14.
The list of verbs as published in the syllabus is given for reference on the inside back cover of this question paper.
Write your candidate number, the paper number and examination subject title in the spaces provided on the front of the answer book. Also write your contact ID and name in the space provided in the right hand margin and seal to close.
Tick the appropriate boxes on the front of the answer book to indicate the questions you have answered.

F2 – Financial Management

SECTION A – 50 MARKS

[Note: The indicative time for answering this section is 90 minutes]

ANSWER *ALL* FIVE QUESTIONS IN THIS SECTION – 10 MARKS EACH

Question One

The statements of comprehensive income for AB, CD and EF for the year ended 31 May 2009 are shown below:

	AB	**CD**	**EF**
	$000	**$000**	**$000**
Revenue	6,000	3,000	1,000
Cost of sales	(4,800)	(2,400)	(800)
Gross profit	1,200	600	200
Distribution costs	(64)	(32)	(10)
Administrative expenses	(336)	(168)	(52)
Finance costs	(30)	(15)	(5)
Profit before tax	770	385	133
Income tax expense	(204)	(102)	(33)
PROFIT FOR THE YEAR	566	283	100
Other comprehensive income:			
Revaluation of property	200	100	30
Tax effect of revaluation	(42)	(21)	(6)
Other comprehensive income for the year, net of tax	158	79	24
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	724	362	124

Additional information:

1. AB operates a defined benefit pension plan for its employees. At the year end, there is an actuarial loss of $52,000 on the pension plan liabilities and an actuarial gain of $40,000 on pension plan assets. These amounts are not reflected in the above statements. In accordance with the amendment to IAS 19 *Employee Benefits*, AB recognises actuarial gains and losses from the defined benefit plan in other comprehensive income in the period that they occur.

2. AB holds a 15% investment in XY which is designated as available for sale. The fair value of this investment at 31 May 2009 was $106,000. The investment is currently recorded in the financial statements at $92,000.

3. AB owns 80% of the ordinary share capital of CD and exercises control over its operating and financial policies. AB owns 30% of the ordinary share capital of EF and exerts significant influence over its operating and financial policies.

Required:

Prepare the consolidated statement of comprehensive income for the AB Group, taking account of the information provided in the notes above. Ignore any further taxation effects of notes 1 and 2.

(Total for Question One = 10 marks)

Question Two

Shareholders are becoming increasingly interested in the environmental policies, impacts and practices of business entities, however financial statements have not traditionally provided this information. As a result, there has been significant growth in entities providing narrative environmental information on a voluntary basis.

Required:

Identify and explain the principal arguments against voluntary disclosures by business entities of their environmental policies, impacts and practices.

(Total for Question Two = 10 marks)

Section A continues on the next page

TURN OVER

Question Three

Convertible bonds

RP issued $4 million 5% convertible bonds on 1 October 2008 for $3.9 million. The bonds have a four year term and are redeemable at par. At the time the bonds were issued the prevailing market rate for similar debt without conversion rights was 7%. The effective interest rate associated with the bonds is 7% and the liability is measured, in accordance with IAS 39 *Financial Instruments: recognition and measurement*, at amortised cost. The interest due was paid and recorded within finance costs during the year.

Share options

RP granted share options to its 300 employees on 1 October 2007. Each employee will receive 1,000 share options provided they continue to work for RP for the following three years from the grant date. The fair value of the options at the grant date was $1.10 each. In the year ended 30 September 2008, 10 employees left and another 30 were expected to leave over the next two years. For the year ended 30 September 2009, 20 employees left and another 15 are expected to leave in the year to 30 September 2010.

Required:

(a) Prepare the accounting entries to record the issue of the convertible bonds and to record the adjustment required in respect of the interest expense on the bonds for the year ended 30 September 2009.

(5 marks)

(b) Discuss the accounting treatment to be adopted for the share options and calculate the amount to be recognised in the income statement in respect of these options for the year ended 30 September 2009. Prepare appropriate accounting entries.

(5 marks)

(Total for Question Three = 10 marks)

Question Four

JKA acquired 50% of the issued ordinary share capital of CBX, an entity set up under a contractual agreement as a joint venture between JKA and one of its customers. JKA adopts a policy of proportionate consolidation in accounting for joint ventures.
The statements of financial position for JKA and CBX as at 31 May 2009 are provided below:

	JKA	CBX
ASSETS	**$000**	**$000**
Non-current assets		
Property, plant and equipment	11,000	7,500
Investment in CBX	2,000	-
	13,000	7,500
Current assets		
Inventories	3,100	1,200
Receivables	3,300	1,400
Cash and cash equivalents	600	400
	7,000	3,000
Total assets	20,000	10,500
EQUITY AND LIABILITIES		
Equity		
Share capital ($1 ordinary shares)	10,000	4,000
Revaluation reserve	1,500	500
Other reserves	500	-
Retained earnings	2,000	4,500
Total equity	14,000	9,000
Non-current liabilities	2,000	-
Current liabilities	4,000	1,500
Total liabilities	6,000	1,500
Total equity and liabilities	20,000	10,500

Additional information:

1. **Intra-group trading**

   During the year to 31 May 2009 CBX sold goods to JKA with a sales value of $200,000. 25% of the goods remain in JKA's inventories at the year end. CBX makes 20% margin on all sales.

   The final invoice amount of $34,000 remains unpaid at the year end.

2. **Sale of land**

   On 31 May 2009 JKA sold a piece of land to DEX Finance for $500,000 when the carrying value of the land was $520,000 (the original cost of the asset). Under the terms of the sale agreement JKA has the option to repurchase the land within the next three years for between $560,000 and $600,000 depending on the date of repurchase. The land must be repurchased for $600,000 at the end of the three year period if the option is not exercised before that time.

   JKA has derecognised the land and recorded the subsequent loss within profit for the year ended 31 May 2009.

TURN OVER

Required:

(a) Explain how the sale of the land should be accounted for in accordance with the principles of IAS 18 Revenue and the Framework for Preparation and Presentation of Financial Statements.

(4 marks)

(b) Prepare the consolidated statement of financial position for JKA as at 31 May 2009.

(6 marks)

(Total for Question Four = 10 marks)

Question Five

BG is an entity with several overseas operations. One of its subsidiaries, DG operates in a country which experiences relatively high rates of inflation in its currency, the Dez. Most entities operating in that country voluntarily present two versions of their financial statements: one at historic cost, and the other incorporating current cost adjustments. DG complies with this accepted practice.

Extracts from the income statement of DG, including adjustments for current costs for the year ended 30 June 2009 are shown below:

	Dez'000
Historical cost profit from operations	926
Current cost adjustments:	
Cost of sales adjustment	(82)
Depreciation adjustment	(37)
Monetary working capital adjustment	(9)
Current cost profit from operations	798

Required:

(a) Discuss the defects of historical cost accounting in times of increasing prices.

(4 marks)

(b) Explain how EACH of the three current cost accounting adjustments shown above contributes to the maintenance of capital.

(6 marks)

(Total for Question Five = 10 marks)

End of Section A
Section B starts on the next page

TURN OVER

SECTION B – 50 MARKS

[Note: The indicative time for answering this section is 90 minutes]

ANSWER BOTH QUESTIONS IN THIS SECTION – 25 MARKS EACH

Question Six

The consolidated statement of financial position for MIC as at 31 March 2009 and its comparative for 2008 is shown below:

	2009	2008
ASSETS	**$000**	**$000**
Non-current assets		
Property, plant and equipment	16,800	15,600
Goodwill	2,900	2,400
Investment in associate	8,000	7,800
	27,700	25,800
Current assets		
Inventories	11,600	12,000
Receivables	9,400	8,200
Held for trading investment	2,200	1,800
Cash and cash equivalents	1,400	4,100
	24,600	26,100
Total assets	52,300	51,900
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital ($1 ordinary shares)	12,000	10,000
Share premium	2,800	-
Other reserves	400	400
Retained earnings	7,300	6,300
	22,500	16,700
Non-controlling interest	6,500	6,100
Total equity	29,000	22,800
Non-current liabilities		
Long term loans	14,000	18,000
Current liabilities		
Payables	8,700	10,200
Income tax	600	900
	9,300	11,100
Total liabilities	23,300	29,100
Total equity and liabilities	52,300	51,900

The consolidated income statement for MIC for the year ended 31 March 2009 is shown below:

	$000
Revenue	12,000
Cost of sales	(8,400)
Gross profit	3,600
Distribution costs	(400)
Administrative expenses	(1,260)
Finance costs	(450)
Share of profit of associate	500
Profit before tax	1,990
Income tax expense	(600)
PROFIT FOR THE YEAR	1,390
Attributable to:	
Owners of the parent	1,200
Non-controlling interest	190
	1,390

Additional information

1. There were no disposals of property, plant and equipment in the year. Depreciation charged in arriving at profit totalled $1,800,000.

2. MIC acquired 90% of the ordinary share capital of GH on 1 December 2008 for a cash consideration of $460,000 plus the issue of 1 million $1 ordinary shares in MIC, which had a deemed value of $3.60 per share at the date of acquisition. The fair values of the net assets acquired were as follows:

	$000
Property, plant and equipment	800
Inventories	2,200
Receivables	700
Cash and cash equivalents	200
Payables	(500)
	3,400

MIC made no other purchases or sales of investments in the year. The group policy is to value the non-controlling interest at acquisition at the proportionate share of the fair value of the net assets.

3. Finance costs include interest on loans and any gains or losses on held for trading investments. All interest due was paid in the year.

Required:

Prepare the consolidated statement of cash flows for MIC for the year ended 31 March 2009.

(Total for Question Six = 25 marks)

TURN OVER

Question Seven

XYZ has a strategy of growth by acquisition. Two entities, A and B, have been identified and will be considered at the next board meeting. The target entities are of a similar size and operate within similar economic parameters. Neither entity is listed. The entities are subject to different tax regimes. Takeover is unlikely to be resisted by either entity, provided a reasonable price is offered for the shares.

XYZ can afford to fund only one acquisition and the board are asking for a review of the financial statements of both entities together with a recommendation on which of the entities looks a more promising prospect. In previous acquisitions, the board focussed mainly on key benchmarks of profitability, efficiency and risk and to that end it is expecting any report to include analysis of the following key financial ratios:

- Gross profit percentage
- Profit before tax as a percentage of revenue
- Return on capital employed
- Non-current asset turnover
- Gearing (debt/equity)

The most recent income statements for both A and B are presented below, together with extracts from their statements of financial position.

	A	**B**
	$000	**$000**
Revenue	3,800	4,400
Cost of sales	(2,700)	(2,820)
Gross profit	1,100	1,580
Distribution costs	(375)	(420)
Administrative expenses	(168)	(644)
Finance costs	(25)	(32)
Profit before tax	532	484
Income tax expense	(148)	(170)
PROFIT FOR THE YEAR	384	314
Extracts from statement of financial position	**$000**	**$000**
Total equity	950	1,500
Non-current liabilities (borrowings)	500	650
Non-current assets	1,700	1,500

Additional information:

1. A's administrative expenses include a gain of $350,000 on the disposal of non-current assets, following a major restructuring of the entity. The refocusing of the business activities also resulted in some capital investment which was undertaken near the end of its financial period.

2. A has a Held for Trading investment on the statement of financial position. Entity A made a gain on this investment of $20,000 in the period and this has been deducted from finance costs.

Required:

(a) Prepare a report for presentation to the board of XYZ, which analyses the financial information provided and recommends the most suitable takeover target. (8 marks are available for the calculation of ratios).

(18 marks)

(b) Explain the limitations of analysis when comparing two entities, using A and B as examples.

(7 marks)

(Total for Question Seven = 25 marks)

End of Question Paper.

Maths Tables and Formulae are on pages 12 to 14

MATHS TABLES AND FORMULAE

Present value table

Present value of \$1, 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	0.705	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	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	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 per annum

Receivable or Payable at the end of each year for *n* years $\frac{1-(1+r)^{-n}}{r}$

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	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 receivable or payable 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:

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

LIST OF VERBS USED IN THE QUESTION REQUIREMENTS

A list of the learning objectives and verbs that appear in the syllabus and in the question requirements for each question in this paper.

It is important that you answer the question according to the definition of the verb.

LEARNING OBJECTIVE	VERBS USED	DEFINITION
Level 1 - KNOWLEDGE What you are expected to know.	List State Define	Make a list of Express, fully or clearly, the details of/facts of Give the exact meaning of
Level 2 - COMPREHENSION What you are expected to understand.	Describe Distinguish Explain Identify Illustrate	Communicate the key features Highlight the differences between Make clear or intelligible/State the meaning or purpose of Recognise, establish or select after consideration Use an example to describe or explain something
Level 3 - APPLICATION How you are expected to apply your knowledge.	Apply Calculate/compute Demonstrate Prepare Reconcile Solve Tabulate	Put to practical use Ascertain or reckon mathematically Prove with certainty or to exhibit by practical means Make or get ready for use Make or prove consistent/compatible Find an answer to Arrange in a table
Level 4 - ANALYSIS How are you expected to analyse the detail of what you have learned.	Analyse Categorise Compare and contrast Construct Discuss Interpret Prioritise Produce	Examine in detail the structure of Place into a defined class or division Show the similarities and/or differences between Build up or compile Examine in detail by argument Translate into intelligible or familiar terms Place in order of priority or sequence for action Create or bring into existence
Level 5 - EVALUATION How are you expected to use your learning to evaluate, make decisions or recommendations.	Advise Evaluate Recommend	Counsel, inform or notify Appraise or assess the value of Propose a course of action

Financial Pillar

Management Level Paper

F2 – Financial Management

Specimen Paper

Thursday Afternoon Session