The Examiner's Answers
F1 - Financial Operations
September 2014

Some of the answers that follow are fuller and more comprehensive than would be expected from a well-prepared candidate. They have been written in this way to aid teaching, study and revision for tutors and candidates alike.

SECTION A

Answers to Question One

Rationale
Question One consists of 10 objective test sub-questions. These are drawn from all sections of the syllabus. They are designed to examine breadth across the syllabus and thus cover many learning outcomes.

1.1 A direct tax is one that is **imposed directly on the person/entity required to pay the tax.**

1.2 **D**

1.3 **B**

1.4 The tax gap is the gap between the tax theoretically collectable and the amount actually collected.

1.5

Maximum offset against 2013	$53,000
Maximum offset against 2012	$62,000
	$115,000

$115,000 x 25% = $28,750

Answer = **A**

1.6 **C**

1.7 **B**

1.8 Verifiability and Understandability

1.9
Proportion that is not exempt: 820/1,025 = 80%
Input VAT = $661,250 x 15/115 = 86,250
Answer 86,250 x 80% = $69,000

Answer = A

1.10 When an entity pays a dividend out of post-tax profits to another entity the dividend received has already suffered tax. If the dividend is paid by an entity in a foreign country the tax suffered is referred to as underlying tax.

SECTION B

Answers to Question Two

Answer to *(a)*

Rationale
To test the candidates' understanding of CIMA's code of ethics.
Tests learning outcome B2c.
Suggested Approach
Explain the reasons why the CIMA code of ethics is principles-based. Describe two of the principles in the code of ethics.

(i)
The CIMA code of ethics is principles based as principle based codes are generally regarded as more effective than rule based codes.
There is a tendency to try and circumvent rules. Principles are more flexible and are difficult to circumvent.
Principles can be applied in a wider variety of situations and under a wide variety of accounting and legal regimes.
Principles may encourage users to think about the intent of the code rather than adopt a "tick box" attitude to compliance.

(ii)
A brief description of any two of the following:
<u>Objectivity</u>
Not allowing bias, conflict of interest or influence of others to override professional judgement.
<u>Professional competence and due care</u>
Commitment to maintain level of professional knowledge and skill
<u>Professional behaviour</u>
Comply with relevant laws and regulations and avoid any action that could impact negatively on the reputation of the profession.
<u>Integrity</u>
Being straightforward, honest and truthful in professional matters.
<u>Confidentiality</u>
Respecting the confidential nature of the information you deal with.

Answer to *(b)*

Rationale
To test candidates' understanding of the purpose of the *Conceptual framework for financial reporting (2010).* Tests learning outcome B1d.
Suggested Approach
Explain the purpose of the *Conceptual framework for financial reporting (2010).*

The Conceptual framework for financial reporting (2010) states that the purpose of the *Conceptual framework* is:

a) to assist the Board (IASB) in the development of future IFRSs and in its review of existing IFRSs;
b) to assist the Board in promoting harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by IFRSs;
c) to assist national standard-setting bodies in developing national standards;
d) to assist preparers of financial statements in applying IFRSs and in dealing with topics that have yet to form the subject of an IFRS;
e) to assist auditors in forming an opinion on whether financial statements comply with IFRSs;
f) to assist users of financial statements in interpreting the information contained in financial statements prepared in compliance with IFRSs;
g) to provide those who are interested in the work of the IASB with information about its approach to the formulation of IFRSs.
h) *The Conceptual Framework* lays out broad principles and is not an international financial reporting standard; it does not override the requirements of any IAS or IFRS.

Answer to *(c)*

Rationale
To test candidates' knowledge of IFRS 8 *Operating Segments*. Tests learning outcome C2a.
Suggested Approach
Explain the 10% rule for identifying reportable segments. Apply the 10% rule to each geographical segment, to identify the reportable segments. Apply the 75% rule to check that sufficient segments have been included.

According to IFRS 8 *Operating Segments,* a segment should be classified as a reportable segment if it is more than 10% of any of the following:

- Revenue
- Profits
- Losses
- Assets

If after allocating segments according to the 10% rule the external revenue of reportable segments is less than 75% of total revenue, additional segments need to be disclosed as reportable, even if they do not meet the 10% rule.

Applying the above criteria to ACZ's data two segments are reportable based on 10% of revenue: A and D.

10% of segmental profits adds segment E to the list.

All the segments with 10% of segment assets are already included.

The external revenue of the three reportable segments is $970,000 + $1,410,000 + $310,000 = $2,690,000 which is 75.8% of the $3,550,000 total revenue. No further segments need to be disclosed as reportable segments.

Answer to *(d)*

Rationale
To test the candidates' understanding of the treatment of a subsidiary entity in the statement of financial position. Tests learning outcome C1b&d.
Suggested Approach
Explain how the investment in EZ should be classified in the consolidated financial statements. Calculate goodwill arising on the acquisition of EZ and make the adjustment for the impairment. Explain the impact on the statement of financial position.

(i) XYK has acquired 100% of EZ's equity shares. EZ will therefore be treated as a subsidiary in the consolidated financial statements. **0.5**

Purchase of EZ shares:

	$000
Cost	975
Net assets acquired (500+170)=	(670)
Fair value adjustment	(140)
Goodwill	165
Impairment	(33)
	132

XYK Group consolidated statement of financial position as at 31 March 2014 (extract)

	$000
Non-current assets	
Goodwill	132

(ii) EZ should be consolidated with XYK in the group consolidated financial statements as at 31 March 2014.

EZ should be consolidated into the statement of financial position by including all its assets and liabilities at their fair value under the relevant asset and liability headings. The difference between the price paid ($975,000) and the fair value of the net assets acquired ($810,000) is recognised as goodwill at 1 April 2013. Goodwill should be annually reviewed for impairment. An impairment of 20% has arisen in the year to 31 March 2014. $33,000 impairment will need to be written off goodwill at 31 March 2014. The $33,000 will be deducted from goodwill in the statement of financial position and deducted from retained earnings.
Any inter entity balances between EZ and XYK at each year end will need to be cancelled out in the consolidated financial statements.

Answer to *(e)*

Rationale
To test candidates’ understanding of corporate income tax calculations. Tests learning outcome A3a.
Suggested Approach
Calculate SMB’s accounting depreciation charge for the year ended 31 March 2014. Calculate SMB’s tax depreciation charge for the year ended 31 March 2014. Calculate SMB’s taxable profits for the year to 31 March 2014. Multiply by the tax rate to give the tax due for the year ended 31 March 2014.

Workings	$
Depreciation	
Cost additional vehicle	46,000
Depreciation (46,000-4,000)/7=	6,000
Depreciation other assets	19,000
	25,000
Tax depreciation	
Cost additional vehicle	46,000
First year allowance	23,000
Other assets	22,000
	45,000

Tax calculation	$
Profit	85,000
Add depreciation	25,000
Less tax depreciation	(45,000)
Less non-taxable grant	(5,000)
Add entertaining	,000
	63,000
Tax @25%	15,750

SMB tax due for the year ended 31 March 2014 is $15,750.

Answer to *(f)*

Rationale
To test candidates' knowledge of tax base and the calculation of deferred tax. Tests learning outcome A4a.
Suggested Approach
Calculate the temporary difference arising in the year to 31 March 2014. Calculate the deferred tax balance at 31 March 2014. Calculate the tax charge to the statement of profit or loss for the year ended 31 March 2014.

(i)

Deferred tax, temporary difference arising in year to 31 March 2014:

Accounting depreciation = $25,000
Tax depreciation = $45,000
Temporary difference arising in year $45,000 - $25,000 = $20,000 x 25% = $5,000

Deferred tax balance on statement of financial position = $155,000 + $5,000 = $160,000

(ii)

	$
Tax under-provided in year to 31 March 2013 (33,000-30,000)	3,000
Tax charge for year ended 31 March 2014 (from part (e))	15,750
	18,750
Add increase in deferred tax for year	5,000
Tax charge in statement of profit or loss for year ended 31/3/2014	23,750

SECTION C

Question Three

Rationale

To test candidates' ability to prepare a set of financial statements for a single entity, including the application of a number of IFRS/IAS.

Tests learning outcome C2a and C1a.

Suggested Approach

Prepare the non-current asset depreciation and development amortisation calculations
Prepare workings for cost of sales, administration and distribution
Prepare all other required workings
Prepare the statement of comprehensive income
Prepare the statement of financial position
Prepare the statement of changes in equity

ZXC - Statement of profit or loss for the year ended 31 March 2014

		$000	$000
Revenue			3,700
Cost of sales	W3		(2,266)
Gross Profit			1,434
Administrative expenses	W3	(267)	
Distribution costs	W3	(154)	(421)
Profit from operations			1,013
Finance cost	W4		(56)
Profit before tax			957
Income tax expense	W5		(121)
Profit for the period			836

ZXC – Statement of changes in equity for the year ended 31 March 2014

	Equity shares	*Treasury Shares*	*Share Premium*	*Retained Earnings*	*Total*
	$000	*$000*	*$000*	*$000*	*$000*
Balance at 1 April 2013	1,200	0	120	173	1,493
Statement of comprehensive income for year				836	836
Treasury shares W8		(252)			(252)
Dividend paid				(97)	(97)
Balance at 31 March 2014	1,200	(252)	120	912	1,980

ZXC - Statement of Financial Position at 31 March 2014

		$000	$000
Non-current assets			
Property, plant and equipment	W1		2,487
Deferred development expenditure	W2		126
Current assets			
Inventory		285	
Trade receivables		263	
Cash and cash equivalents		64	
			612
Total assets			3,225
Equity and liabilities			
Equity			
Share capital		1,200	
Share premium		120	
Treasury shares		(252)	
Retained earnings		912	
Total equity			1,980
Non-current liabilities			
Long term borrowings		600	
Finance lease	W7	96	
Deferred tax	W5	61	
Total non-current liabilities			757
Current liabilities			
Trade payables		319	
Tax payable		125	
Finance lease	W7	28	
Interest payable	W4	16	
Total current liabilities			488
Total equity and liabilities			3,225

Workings (All figures in $000)

(W1) Non-current assets

Cost	Land	Buildings	Plant and equipment	Motor vehicle	Total
Balance b/fwd	1,200	1,345	615	0	3,160
Finance lease				144	144
Disposal (W6)	0	0	(75)	0	(75)
Balance c/fwd	1,200	1,345	540	144	3,229
Depreciation					
Balance b/fwd	0	322	355	0	677
Disposal (W6)	0	0	(43)	0	(43)
	0	322	312	0	634
Year (1,345x2%)		27			27
Year (540-312)x25%			57		57
Year (144/6)	0	0	0	24	24
Balance c/f	0	349	369	24	742
Carrying Value	1,200	996	171	120	
Total P, P&E c/f					2,487

(W2) Deferred Development Expenditure

Balance b/f	210
Years amortisation –	(42)
Amortisation b/f	(42)
Balance c/f	126

(W3)

	Cost of sales	*Admin*	*Distribution*
Trial balance	2,154	240	130
Amortisation development expenditure W2	42		
Depreciation – vehicle W1			24
Depreciation – buildings W1		27	
Depreciation – plant and equipment W1	57		
Loss on disposal PPE W6	13		
Totals	2,266	267	154

(W4) Interest

Balance b/f	32
Accrue 4 months	16
Years loan interest	48
Finance lease interest	8
	56

(W5) Tax

Last Year b/f	11
Current year	125
	136
Increase in deferred tax	(15)
	121
Decrease in Deferred tax	
Balance b/f	76
Decrease	(15)
	61

(W6) Disposal of plant and equipment

Cost	75
Less depreciation (balance)	(43)
Carrying value	32
Proceeds	19
Loss on disposal	(13)

(W7) Finance lease

Year to:	Balance B/f	Paid	Sub-total	Interest	Balance C/f
31/3/2014	144	-28	116	8	124
31/3/2015	124	-28	96	6	102

NCL	96
CL	28

(W8) Treasury shares

Purchase cost 240 x 1.05 = 252

Debit to equity 252
Credit to suspense 252

Question Four

Rationale
To test candidates' understanding of a Statement of cash flows.
Tests learning outcome C1a.
Suggested Approach
Draft the outline headings for a statement of cash flows. Complete the cash generated from operations section. Calculate the tax and interest paid and put in statement of cash flows. Calculate the cash flows from movements in non-tangible assets and complete cash flows from investing activities. Calculate dividends paid and complete cash flows from financing activities. Complete the statement of cash flows.

EBS Statement of Cash flows for the year ended 30 June 2014

	$000	*$000*
Cash flows from operating activities		
Profit before taxation		1,358
Adjustments for:		
Legal claim provision	62	
Depreciation (W1)	450	
Amortisation of development expenditure (W6)	27	
Impairment of brand name (W2)	15	
Finance cost	57	
Loss on disposal of non-current tangible asset (W8)	35	646
Operating profit before working capital changes		2,004
Increase in inventory	(25)	
Increase in trade receivables	(84)	
Decrease in trade payables	(12)	(121)
Cash generated from operations		1,883
Interest paid (W7)	(68)	
Income taxes paid (W3)	(104)	(172)
Net cash from operating activities		1,711
Cash flows from investing activities		
Purchase of property, plant and equipment (W1)	(475)	
Proceeds from sale of equipment	25	
Development expenditure (W6)	(135)	
Net cash from investing activities		(585)
		1,126
Cash flows from financing activities		
Proceeds from issue of equity share capital (W5)	580	
Proceeds from issue of preferred shares	300	
Repayment of long term borrowings	(1,435)	
Equity dividends paid* (W4)	(612)	
Net cash from financing activities		(1,167)
Net decrease in cash and cash equivalents		(41)
Cash and cash equivalents at 30 June 2013		210
Cash and cash equivalents at 30 June 2014		169

Workings

W1 – Non-current assets

	Property $000	Plant $000	Equipment $000	
Cost or valuation				
At 30 June 2013	3,900	2,850	1,120	
Disposals			(210)	
Adjustment on revaluation	(75)			
	3,825	2,850	910	
At 30 June 2014	3,825	3,000	1,235	
Additions (to balance)	0	150	325	475
Depreciation				
At 30 June 2013	(420)	(1,700)	(860)	
Disposals			150	
Adjustment on revaluation	420			
	0	(1,700)	(710)	
At 30 June 2014	(45)	(2,000)	(815)	
Charge for year (to balance)	45	300	105	450

W2 Brand name

	$000
Balance 30 June 2013	60
Balance 30 June 2014	45
Impairment	15

W3 Income Taxes paid

	$000	**$000**
Balance 30 June 2013 – corporate income tax		120
Deferred tax 30 June 2013		110
Income statement		160
		390
Balance 30 June 2014 – corporate income tax	(90)	
- deferred tax	(196)	(286)
Tax paid		104

W4 – Dividends Paid

	$000
Retained earnings balance 30 June 2013	1,420
Profit for year	1,198
	2,618
Retained earnings Balance 30 June 2014	2,006
Dividends paid	612

W5 – Proceeds from issue of share capital

	$000
Shares	400
Share premium	180
Received	580

W6 – Deferred development expenses

	$000
Balance 30 June 2013	76
Amortised in year	(27)
	49
Balance 30 June 2014	184
Additions (to balance)	135

W7 – Interest paid

		$000
Balance 30 June 2013		15
Income Statement		57
		72
Less balance 30 June 2014		(4)
Paid		68
Preference dividend	18	
Other interest (balance)	50	68

W8 – Disposal of equipment

	$000
Cost (W1)	210
Depreciation (W1)	150
Carrying value	60
Cash received	25
Loss on disposal	35