Financial Pillar

F2 – Financial Management

26 May 2011 – Thursday Afternoon Session

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).
ALL answers must be written in the answer book. Answers written on the question paper will **not** be submitted for marking.
You should show all workings as marks are available for the method you use.
ALL QUESTIONS ARE COMPULSORY.
Section A comprises 5 questions and is on pages 2 to 6.
Section B comprises 2 questions and is on pages 8 to 11.
Maths tables and formulae are provided on pages 13 to 15.
The list of verbs as published in the syllabus is given for reference on page 19.
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

[You are advised to spend no longer than 18 minutes on each question in this section.]

ANSWER *ALL* FIVE QUESTIONS IN THIS SECTION

Question One

(a)

EAU operates a defined benefit pension plan for its employees. At 1 January 2010 the fair value of the pension plan assets was $2,600,000 and the present value of the plan liabilities was $2,900,000.

The actuary estimates that the current and past service costs for the year ended 31 December 2010 is $450,000 and $90,000 respectively. The past service cost is caused by an increase in pension benefits. The plan liabilities at 1 January and 31 December 2010 correctly reflect the impact of this increase.

The interest cost on the plan liabilities is estimated at 8% and the expected return on plan assets at 5%.

The pension plan paid $240,000 to retired members in the year to 31 December 2010. EAU paid $730,000 in contributions to the pension plan and this included $90,000 in respect of past service costs.

At 31 December 2010 the fair value of the pension plan assets is $3,400,000 and the present value of the plan liabilities is $3,500,000.

In accordance with the amendment to IAS 19 *Employee Benefits*, EAU recognises actuarial gains and losses in other comprehensive income in the period in which they occur.

Required:

Calculate the actuarial gains or losses on pension plan assets and liabilities that will be included in other comprehensive income for the year ended 31 December 2010. (Round all figures to the nearest $000).

(5 marks)

(b)

EAU granted 1,000 share appreciation rights (SARs), to its 300 employees on 1 January 2009. To be eligible, employees must remain employed for 3 years from the date of issue and the rights must be exercised in January 2012, with settlement due in cash.

- In the year to 31 December 2009, 32 staff left and a further 35 were expected to leave over the following two years.
- In the year to 31 December 2010, 28 staff left and a further 10 were expected to leave in the following year.
- No actual figures are available as yet for 2011.

The fair value of each SAR was $8 at 31 December 2009 and $12 at 31 December 2010.

Required:

Prepare the accounting entry to record the expense associated with the SARs, for the year to 31 December 2010, in accordance with IFRS 2 *Share-based Payments*.

(5 marks)

(Total for Question One = 10 marks)

Question Two

RBE owns 70% of the ordinary share capital of DCA. The total group equity as at 31 December 2009 was $4,000,000, which included $650,000 attributable to non-controlling interest.

RBE purchased a further 20% of the ordinary share capital of DCA on 1 October 2010 for $540,000.

During the year to 31 December 2010, RBE issued 2 million $1 ordinary shares, fully paid, at $1.30 per share.

Dividends were paid by both group entities in April 2010. The dividends paid by RBE and DCA were $200,000 and $100,000, respectively.

Total comprehensive income for the year ended 31 December 2010 for RBE was $900,000 and for DCA was $600,000. Income is assumed to accrue evenly throughout the year.

Required:

(a) **Explain** the impact of the additional 20% purchase of DCA's ordinary share capital by RBE on the equity of the RBE Group.

(3 marks)

(b) **Prepare** the consolidated statement of changes in equity for the year ended 31 December 2010 for the RBE Group, showing the total equity attributable to the parent and to the non-controlling interest.

(7 marks)

(Total for Question 2 = 10 marks)

TURN OVER

Question Three

The directors of FGH have agreed as part of their strategic plan to list the entity's equity shares on the local stock exchange.

At a recent board meeting, the directors discussed, in overview, the additional compliance that would be required upon listing. This included compliance with the requirements of IFRS 8 *Operating Segments* (IFRS 8). The managing director commented that adherence to the requirements of IFRS 8 would be time-consuming and costly due to the additional financial information that the entity would have to prepare.

Required:

(a) **Discuss** whether the managing director's comment is accurate in respect of the operating segment analysis that is required in accordance with IFRS 8.

(4 marks)

(b)

(i) **Explain** why the information that is presented for operating segments is likely to be highly relevant to investors

(ii) **Discuss** the potential limitations of operating segment analysis as a tool for comparing different entities.

(6 marks)

(Total for Question Three = 10 marks)

Question Four

(a) QWE issued 10 million 5% convertible $1 bonds 2015 on 1 January 2010. The proceeds of $10 million were credited to non-current liabilities and debited to bank. The 5% interest paid has been charged to finance costs in the year to 31 December 2010.

The market rate of interest for a similar bond with a five year term but no conversion terms is 7%.

Required:

Explain AND **demonstrate** how this convertible instrument would be initially measured in accordance with IAS 32 *Financial Instruments: Presentation* AND subsequently measured in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* in the financial statements for the year ended 31 December 2010.

(7 marks)

(b) The directors of QWE want to avoid increasing the gearing of the entity. They plan to issue 5 million 6% cumulative redeemable $1 preference shares in 2011.

Required:

Explain how the preference shares would be classified in accordance with IAS 32 *Financial Instruments: Presentation,* AND the impact that this issue will have on the gearing of QWE.

(3 marks)

(Total for Question Four = 10 marks)

TURN OVER

Question Five

BNM is a knowledge-based business which relies on key personnel and internally generated intellectual capital to generate revenue. BNM is listed on a local exchange. The directors believe that the information provided by the annual financial report fails to provide a complete picture of the activities and economic environment in which BNM operates. They are keen to ensure that current and potential investors are aware of the intellectual property that is a primary resource in the business. The business has cultivated key customer relationships and as a result has secured four large contracts that will run for at least the next three years.

The directors of BNM consider themselves to be socially and environmentally aware and have made efforts to improve the entity's reputation as a good corporate citizen. They are considering including some form of additional narrative disclosure within the next annual report.

Required:

(a) **Discuss** the potential advantages that could be ***gained by BNM*** if it included voluntary narrative disclosures within the annual report.

(6 marks)

(b) **Discuss** the potential drawbacks of voluntary disclosures being included in annual reports.

(4 marks)

(Total for Question Five = 10 marks)

(Total for Section A = 50 marks)

End of Section A

Section B starts on page 8

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TURN OVER

SECTION B – 50 MARKS

[You are advised to spend no longer than 45 minutes on each question in this section.]

ANSWER BOTH QUESTIONS IN THIS SECTION – 25 MARKS EACH

Question Six

Extracts from the financial statements of A, its subsidiary, B and its associate, C for the year to 30 September 2010 are presented below:

Summarised statement of comprehensive income	***A***	***B***	***C***
	A$000	*B$000*	*A$000*
Revenue	4,600	2,200	1,600
Cost of sales and operating expenses	(3,700)	(1,600)	(1,100)
Profit before tax	900	600	500
Income tax	(200)	(150)	(100)
Profit for the year	700	450	400
Other comprehensive income:			
Revaluation of property, plant and equipment	200	120	70
Total other comprehensive income	200	120	70
Total comprehensive income	900	570	470

Statement of financial position	***A***	***B***	***C***
	A$000	*B$000*	*A$000*
Assets			
Non-current assets			
Property, plant and equipment	7,000	4,000	2,000
Investment in B	5,200		
Investment in C	900		
	13,100	4,000	2,000
Current assets	3,000	2,000	1,000
Total assets	16,100	6,000	3,000
Equity and liabilities			
Share capital	2,000	1,000	1,000
Reserves	12,100	3,500	1,500
	14,100	4,500	2,500
Current liabilities	2,000	1,500	500
Total equity and liabilities	16,100	6,000	3,000

Additional information

1. The functional currency of both A and C is the A$ and the functional currency of B is the B$.
2. A acquired 80% of B on 1 October 2007 for A$5,200,000 when the reserves of B were B$1,800,000. The investment is held at cost in the individual financial statements of A.
3. A acquired 40% of C on 1 October 2005 for A$900,000 when the reserves of C were A$700,000. The investment is held at cost in the individual financial statements of A.
4. No impairment to either investment has occurred to date.
5. The group policy is to value the non-controlling interest at fair value at the date of acquisition. The fair value of the non-controlling interest of B at 1 October 2007 was B$600,000.
6. Relevant exchange rates are as follows:

1 October 2007	A$/B$0.5000
30 September 2009	A$/B$0.7100
30 September 2010	A$/B$0.6300
Average rate for year ended 30 September 2010	A$/B$0.6500

Required:

Prepare the consolidated statement of comprehensive income for the A Group for the year ended 30 September 2010 and the consolidated statement of financial position as at that date.

(Total for Question Six = 25 marks)

Section B continues on the next page

TURN OVER

Question Seven

A friend has recently inherited some money and has approached you seeking investment advice. She has an interest in fashion and has decided to invest in the fashion retail sector. She has performed some initial research which concentrated on the social and economic policies of a number of entities. She has selected a listed entity, CVB, for potential investment as she was particularly impressed with the fact that they had recently introduced a new line of fair-trade clothing.

She has asked that you help with a review of the financial information before she makes her final decision to invest. CVB's current share price is $1.25 per share, which is 40% lower than at the same time last year.

The financial statements for CVB are provided below:

Consolidated statement of financial position as at 30 September	***2010***	***2009***
ASSETS	***$m***	***$m***
Non-current assets		
Property, plant and equipment	262	235
Investment in associate	14	16
	276	251
Current assets		
Inventories	140	87
Trade and other receivables	75	63
Cash and cash equivalents	-	9
	215	159
Held for sale assets	4	-
Total assets	495	410
EQUITY AND LIABILITIES		
Equity attributable to owners of the parent		
Share capital ($1 shares)	30	30
Share premium	48	48
Retained reserves	179	164
	257	242
Non-controlling interest	16	14
Total equity	273	256
Non-current liabilities		
Long-term borrowings	55	58
Deferred tax provision	5	1
	60	59
Current liabilities		
Trade and other payables	144	95
Short-term borrowings	18	-
	162	95
Total liabilities	222	154
Total equity and liabilities	495	410

Consolidated statement of comprehensive income for the year ended 30 September	***2010***	***2009***
	$m	***$m***
Revenue	453	412
Cost of sales	(305)	(268)
Gross profit	148	144
Sales and marketing costs	(66)	(60)
Administrative expenses	(62)	(64)
Finance costs	(8)	(5)
Share of (loss)/profit of associate	(2)	3
Profit before tax	10	18
Income tax expense	(2)	(5)
Profit for the year	8	13
Other comprehensive income		
Revaluation gains from property (net of tax)	14	-
Total comprehensive income	22	13
Profit for the year attributable to:		
Equity holders of the parent	7	11
Non-controlling interest	1	2
	8	13
Total comprehensive income attributable to:		
Equity holders of the parent	21	11
Non-controlling interest	1	2
	22	13

Required:

(a) **Analyse** and **prepare** a report on the financial performance and financial position of CVB. *(8 marks are available for the calculation of **relevant** ratios.)*

(20 marks)

(b) **Explain** what further financial information may assist your friend in deciding whether or not to invest in CVB.

(5 marks)

(Total for Question Seven = 25 marks)

(Total for Section B = 50 marks)

End of Question Paper

Maths Tables and Formulae are on pages 13 to 15

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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 (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	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 (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 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:

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

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

Financial Pillar

Management Level Paper

F2 – Financial Management

May 2011

Thursday Afternoon Session