SUBJECT NO 15J

FINANCIAL ACCOUNTING
MAY 2004

The examination paper is divided into TWO Sections. Section A is compulsory and carries 40 marks. Candidates should attempt THREE questions from Section B, all of which carry 20 marks each.

You should allow yourself approximately 70 minutes in total to answer the questions in Section A, and 35 minutes for each of the questions attempted in Section B.

Tuesday morning 25th May 2004 *Time allowed: 3 hours*

SECTION A
(Compulsory- all questions carry equal marks)

1. (a) Name four components of financial statements as mentioned in FRS 1 Presentation of Financial Statements.

(b) List four items disclosed in the " Domicile and Activities"/ "Corporate Information" in the notes to the financial statements as stated in FRS 1?

(c) (i) " What are the assets that should be accounted for as "inventories" under FRS 2 Inventories?". (2 marks)

(ii) What should the cost of inventories comprise? (2 marks)

(d) A separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the enterprise. List four examples of cash flows arising from financing activities.

(e) When items of income and expense within profit or loss from ordinary activities are of such size, nature or incidence that their disclosure is relevant to explain the performance of the enterprise for the period, the nature and amount of such items should be disclosed separately. List four examples of such items.

(f) Under the "benchmark" treatment on changes in accounting policies as provided for in FRS 8 Net Profit or Lose for the period, Fundamental Errors and Changes in Accounting Policies, what should an enterprise disclose when a change in accounting policy has a material effect on the current period or any prior period presented, or may have a material effect in subsequent periods?

(g) List four examples of non-adjusting events after the balance sheet date that may be of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.

(h) A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. Name four factors that should be considered in determining whether products and services are related.

(i) Segment expense is an expense resulting from the operating activities of a segment that is directly attributable to the segment and the relevant portion of an expense that can be allocated on a reasonable basis to the segment, including expenses relating to sales to external customers and expenses relating to transactions with other segments of the same enterprise. List four items that are not included in the determination of segment expense.

(j) Name four pieces of information that the financial statements should disclose for each class of fixed assets under FRS 16 Property, Plant and Equipment.

(Total: 40 marks)

SECTION B
(*Answer THREE questions from this Section*)

2. As a financial analyst, you have gathered the following information on *Brentwood Limited ("Brentwood")* for its financial year ending 30 June 2004:

- *Brentwood* holds 4 million shares, acquired at a cost of 25 cents each, in a company which has been placed under liquidation. The company, *Softwood Ltd* has a paid-up capital of $10 million, comprising shares with a par value of 50 cents. The total liabilities of the company are $5,800,000. The liquidators estimated the net realisable value of the company's total assets and their fees payable to be $7,400,000 and $200,000 respectively.

- *Brentwood* has awarded a contract to *Beeswood Ltd* for the supply of 2,400,000 units of *Barble Toys* per year. The contract sum is $4,800,000. Under the terms of the contract, *Beeswood Ltd* has to supply 200,000 units of toys per month. Any late supply of the toys carries liquidated damages of $1.00 per unit. However, *Beeswood Ltd* had failed to supply the toys for the last four months due to a strike at its factory. Beeswood Ltd has agreed, and is able to pay the liquidated damages.

- *Daniel Toys Ltd* filed a suit against *Brentwood* for infringement on the design of a toy. Counsel for *Brentwood* thinks that it is probable that it will loss the case. The cost of damages payable is estimated to be $2,200,000. Legal costs are approximately $60,000.

- *Brentwood* bank's prime rate fell by 0.5% from 1 January 2004 to 30 June 2004.

- *Brentwood* decided to close one of its retail outlets on 1 January 2004. The written-down value for the renovation cost of this outlet is stated in the accounts as $800,000. Five staff, with a total wage cost of $10,000 per month, will be retrenched, and no retrenchment benefit will be paid.

- Operating costs are under control and are not expected to escalate in 2004. *Brentwood's* operating profit is estimated to improve by another 3% despite the above mentioned events. Tax rate remains unchanged at 25% Assume all adjustments are taxable/deductible for tax purposes.

You have obtained a copy of *Brentwood's* annual report for the year ended 30 June 2003. It shows the following balance sheet and profit and loss account:

Balance Sheet

	$'000		*$'000*
Paid-up capital	200,000	Fixed assets	280,000
Share premium account	24,500	Investments	37,400
Accumulated profits	74,100	Brands	8,600
Long-term liabilities	30,000	Current assets	32,400
Current liabilities	29,800		
	358,400		358,400
	======		======

Profit & Loss Account

	$'000
Turnover	230,000
	======
Operating profit	18,000
Less: Tax	4,500
Net profit after tax	13,500
Accumulated profit b/fwd	60,600
Accumulated profit c/fwd	74,100
	======

Notes to the accounts:

- Long-term liabilities consist of:
  - (i) Loan 1 : $20 million at 3% over prime rate of 7%. This loan is repayable over 10 years by yearly instalments at the end of each year.
  - (ii) Loan 2 : $10 million at fixed interest of 4.5% repayable over 5 years by yearly instalments at the end of each year.

- Paid-up capital consists of ordinary shares at 50 cents each. The market price is $2.00 per share.

Required

a) Compute *Brentwood's* earnings per share as at 30 June 2003. (2 marks)

b) Estimate the prospective earnings per share for the year ending 30 June 2004. (13 marks)

c) It has been circulating in the market that *Brentwood* would be declaring a bonus issue of 1:2. Is there a possibility for such an issue? (5 marks)
(Total 20 marks)

3. *Newtech* has a paid-up capital of $500 million as follows:

Ordinary shares (par value $1.00)	$400 million
Preference shares (par value $1.00)	$100 million

The preference shares carry a dividend rate of 10% gross. The tax rate for 2004 is 30%.

On 28 December 2003, the *Busy Times* reported that *Newtech Limited ("Newtech")* purchased 120 million shares in *Beta Limited* at 50 cents per share, and 50 million shares in *Alpha Limited* at 20 cents per share on 15 December 2003.

The paid-up capital of *Beta Limited* is $100 million with a par value of 25 cents. The company is estimated to make a loss after tax of $9 million for 2004. However, dividend would be maintained at the previous level of $1,500,000, gross. *Alpha Limited* has a paid-up capital of $50 million with a par value of 10 cents. Its projected profit after tax for 2004 is $5 million. Dividend for 2004 is estimated at $400,000, gross.

Two days later, the newspaper report that *Newtech* had agreed to acquire 150 million shares out of 200 million shares in the issued and paid up capital of *Delta Limited* on 31 December 2003. The purchase price was agreed at $200 million. The fair value of net assets to be taken over was agreed at $160 million. Goodwill arising from the acquisition would be amortised on a straight line basis over 10 years. *Newtech* is financing the acquisition by issuing its ordinary shares at $2.00 per share.

Delta Limited's projected profit after tax for the year ending 31 December 2004 is $10 million, excluding the income from the above investments, *Newtech* is expected to achieve profit before tax of $28 million.

Required

Compute the following for *Newtech*:

(a) Goodwill on consolidation. (3 marks)

(b) The projected minority interest in the consolidated balance sheet as at 31 December 2004. (3 marks)

(c) *Newtech's* projected group earnings for the year ended 31 December 2004, after deduction of preference dividend. (10 marks)

(d) The projected value of investments in *Beta Limited* and *Alpha Limited* in the consolidated balance sheet as at 31 December 2004. (4 marks)

(Total 20 marks)

4.

Buffy Limited

Balance Sheet as at 31 December 2003

	$'000		*$'000*
Issued capital (par value 25 cents)	200,000	Fixed assets	156,000
Share premium	5,400	Research & development	56,000
Accumulated profits	8,100	Stock	32,600
Long term loans	15,000	Trade receivables	17,800
Trade payables	26,400	Cash at bank	4,300
Other payables	11,800		
	266,700		266,700

(a) Compute *Buffy Limited's* working capital position as at 31 December 2003.

(6 marks)

(b) Compute working capital position of *Buffy Limited* as at 31 December 2004 based on the following information:

(i) On 2 Mar 2004, the company paid a further sum of $400,000 for research and development.

(ii) The company acquired additional fixed assets on 1 February 2004 costing $2,400,000. This acquisition was financed through short-term borrowings.

(iii) A machinery was sold by the company on 15 April 2004 for $120,000. The machinery was acquired on 20 May 1992. It is the company's accounting policy to depreciate its machinery on a straight-line basis over 5 years. Full year depreciation is made for the year the machinery is acquired.

(iv) The company issued rights shares on the basis of 1:5 at 70 cents per share on 15 January 2004. The shares were fully subscribed on 28 March 2004.

(v) The projected profit before tax for the year ending 31 December 2004 is $5,700,000. This projection is arrived at after taking into consideration depreciation of $830,000 and gain on disposal of machinery (see (iii) above) of $120,000.

(vi) An interim dividend of $4,200,000 was paid on 8 February 2004.

(14 marks)

(Total:20marks)

5. *Chic Limited* is a company trading in fashion goods, such as clothings, watches, imitation jewellery and related goods. Its financial statements for the year ended 31 March 2004 were as follows:

Balance Sheets

	2004	2003
	$'000	*$'000*
Fixed assets	34,600	33,000
Current assets		
Inventory	24,800	21,200
Trade receivables	15,400	9,100
Other receivables	600	700
Cash at bank	7,600	-
	48,400	31,000

Current liabilities		
Trade payables	10,600	7,100
Bank overdraft	-	6,500
Other payables	750	600
Tax payable	1,950	1,500
	13,300	15,700
Net current assets	35,100	15,300
Less: Long term loans	20,000	-
	49,700	48,300
	=====	=====
Shareholders' equity		
Paid-up capital (par : 50 cents)	40,000	40,000
Capital reserves	1,710	3,400
Accumulated profits	7,990	4,900
	49,700	48,300
	=====	=====

Profit and Loss Account

	2004 *$'000*	2003 *$'000*
Sales	72,000	57,600
Less: Cost of sales		
Opening inventory	21,200	19,500
Purchases	55,800	41,800
	77,000	61,300
Less: Closing inventory	24,800	21,200
	52,200	40,100
Gross profit	19,800	17,500
Less: Operating expenses		
Selling and distribution	1,930	1,580
Administration and general expenses	3,570	3,000
Depreciation	6,480	6,025
Interest	2,100	1,400
Net operating profit before tax	5,720	5,495
Less: Tax	1,430	1,370
Net profit after tax	4,290	4,125
Less: Dividends	1,200	1,200
Profit retained for the year	3,090	2,925
	=====	=====

Required

a) Compute the following ratios for Chic limited, for the years 2004 and 2003.

(i) current ratio;
(ii) liquid ratio;
(iii) trade receivables turnover;
(iv) Inventory turnover;
(v) gross profit margin;
(vi) operating expenses ratio;
(vii) net profit after tax margin;
(viii) return on equity;
(ix) return on assets; and
(x) interest cover

to the nearest one decimal place (12 marks)

b) Comment on Chic Limited's financial position and operating performance in its financial year ended 31 March 2004 as compared with other firms in the industry. (8 marks)

The industry average are as follows:-

		Industry average
(i)	current ratio;	2.5 x
(ii)	liquid ratio;	1.5 x
(iii)	trade receivables turnover;	30 days
(iv)	Inventory turnover;	60 days
(v)	gross profit margin;	28%
(vi)	operating expenses ratio;	15%
(vii)	net profit after tax margin;	10%
(viii)	return on equity;	12%
(ix)	return on assets; and	8%
(x)	interest cover	4 x

to the nearest one decimal place. (Total 20 marks)

6. The following is the common-size cash flow statement of *Grandeur Limited* for the year ended 31 March 2004:

	2004 %	2003 %
Operating activities		
Profit before tax	71	332
Add: Non cash items	21	61
	92	393
Changes in inventory	(173)	(309)
Changes in trade receivables	(59)	(549)
Changes in trade payables	242	578
Income tax	(2)	(13)
Net cash generated from operating activities	100%	100%

Investing activities		
Purchase of fixed assets	(7)	(100)
Purchase of subsidiary	(148)	-
Sale of fixed assets	18	-
Sale of investments	37	-
Net cash utilized in investing activities	(100)%	(100)%
	===	===
Financing activities		
Long term borrowings	36	-
Short term borrowings	71	13
Share issue	-	95
Dividends paid	(7)	(8)
Net cash utilized in financing activities	100%	100%
	===	===
Net increase in cash balance	100%	100%
	===	===

Required:

Comment on the following for the two years:

a) How was *Grandeur Limited* able to finance its investing activities? (6 marks)

b) How did the company finance its build-up of inventories and trade receivables? (7 marks)

c) What are the potential problems the company is likely to face in 2004? (7 marks)

(Total :20 marks)

END