

Part One – Chartered Governance Qualifying Programme

Interpreting Financial and Accounting Information

Time allowed: 3 hours (plus 15 minutes reading time)

You must not take this paper out of the examination workspace.

The examination paper contains **9** questions of which you must attempt **8**. You must attempt **all questions** in Section A, **the compulsory question** in Section B and **2 questions** in Section C.

Section A contains 25 marks, Section B contains 25 marks and Section C contains 50 marks. There are **100 marks** available in total for the paper.

Section A

Answer **all** the questions in this section.

1. Explain how social accounting operates in companies that are committed to this aim.

(5 marks)

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2. Explain the concept of capital maintenance and how it can be applied to company financial statements.

(5 marks)

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3. Outline how the differences between public and private financial markets affect investors.

(5 marks)

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4. Describe how the dividend valuation model can be used to estimate the value of equity.

(5 marks)

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5. Explain how scenario analysis can assist when evaluating a possible investment.
(5 marks)

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TOTAL FOR SECTION A = 25 MARKS

Section B

Compulsory question – you must answer this question.

Question 6

Clough Bhd (“Clough”) is a long-established producer of soft and carbonated drinks. Most of the company’s operations are concentrated in Malaysia and the company exports to other Asian countries.

Clough has expanded through strategic acquisitions within its established marketplace and has built up a leading range of branded products. As such it has significant intangible assets in its statement of financial position, these being goodwill on acquisitions and valuation of its brands.

Clough is looking to expand and is giving consideration to two major acquisitions within the next twelve months, both for important target companies within the established marketplace. These are expected to be at a cost of around RM85 million and RM150 million respectively, with most of that consideration being paid upon completion of the deals. The completion and timing of one or both deals is still being negotiated.

The expansion plan is intended to deliver better financial results and higher shareholder returns.

Total dividends of RM79 million were paid to Clough’s shareholders in 2022, this having increased from RM76 million in 2021.

The latest financial statements for Clough are as follows:

Statements of profit or loss for the year ended 31 December		
	2022	2021
	RM million	RM million
Revenue	1,504	1,431
Cost of goods sold	(702)	(667)
Gross profit	802	764
Selling and Distribution costs	(401)	(393)
Administrative expenses	(235)	(208)
Operating profit	166	163
Finance costs	(20)	(24)
Profit before tax	146	139
Tax expense	(29)	(27)
Profit for the year (Net profit)	117	112

Statements of financial position as at 31 December		
	2022	2021
	RM million	RM million
ASSETS		
Non-current assets		
Property, plant, and equipment	520	462
Intangible assets	589	579
Total non-current assets	1,109	1,041
Current assets		
Inventories	145	147
Trade and other receivables and cash and cash equivalents	506	425
Total current assets	651	572
Total assets	1,760	1,613

EQUITY AND LIABILITIES		
Share capital (RM1 shares)	53	53
Retained earnings	324	286
Total equity	377	339
Non-current liabilities		
Long-term borrowings	684	656
Total non-current liabilities	684	656
Current liabilities		
Trade and other payables, provisions, and tax	699	618
Total current liabilities	699	618
Total liabilities	1,383	1,274
Total equity and liabilities	1,760	1,613

Share information	2022	2021
Market share price at 31 December	RM8.50	RM8.00
Dividend (per share)	RM1.49	RM1.43

REQUIRED:

- (a) Calculate the relevant ratios (profitability, gearing, liquidity, efficiency, and investment) needed to review the financial performance and position of Clough, including a focus on investor returns. **(Select no more than eight ratios.)**

(8 marks)

- (b) Analyse what the ratios calculated in part (a), together with the financial information provided, reveal about the financial performance and position of Clough over the last two years.

(9 marks)

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- (c) Discuss the long-term finance options available for the two proposed acquisitions in the light of Clough's financial position at the end of 2022.

(8 marks)

[Total for Question 6 = 25 marks]

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TOTAL FOR SECTION B = 25 MARKS

Section C

Answer **two** questions only.

Question 7

Scarpa Berhad (“Scarpa”) is considering investing RM800,000 in equipment to establish a new product line.

The new product is expected to generate sales revenue across a five-year period, at RM600,000 for the first year, RM900,000 for each of the next three years, and RM700,000 for the final year. To produce this revenue, it is anticipated that Scarpa will incur a RM75,000 increase in annual fixed costs, and that annual variable costs will be at 60% of revenue. The scrap value of the equipment at the end of five years has been estimated at RM50,000.

The Board of Scarpa wants to evaluate the financial viability of this proposal. It has calculated that, using a cost of capital of 20%, the project would produce a negative net present value (NPV) of RM60,000. Scarpa has a target rate of return on its capital projects of 15%.

REQUIRED:

Assume that all cash flows occur at the year end.

- (a) Calculate the NPV of the project using a cost of capital of 10%, and then obtain the internal rate of return (IRR) using the NPV that you have calculated, and finally comment on what the results suggest regarding the financial viability of the proposed project. Discounted cash flows should be rounded to the nearest RM100,000.

(15 marks)

- (b) Compare the other main methods that the Board of Scarpa might consider to evaluate this proposed project together with their respective advantages and disadvantages.

(10 marks)

Note:

Calculate IRR using the following formula:

$$\text{IRR} = L + (\text{NPV}_L / (\text{NPV}_L - \text{NPV}_H) \times (H - L))$$

Where:

L and NPV_L represent the lower discount rate and its NPV

H and NPV_H represent the higher discount rate and its NPV

[Total for Question 7 = 25 marks]

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Question 8

Cooper is a group of companies, with Cooper Holdings Bhd as the parent company, and three subsidiary companies: Cooper Electrical Bhd, Cooper Plumbing Bhd, and Cooper Carpentry Bhd. The group has grown over the last decade by Cooper Holdings Bhd strategically purchasing the three subsidiary companies. The purchase of Cooper Plumbing Bhd was a key part of the strategy, and Cooper Holdings Bhd had to pay a price above the fair market value of its net assets.

The aggregate revenue of the group was RM120 million for the year ended 31 December 2022, with the group employing some 600 staff. Cooper continues to invest and grow as a group, and has been pursuing this strategy in several ways as follows:

- During 2021 Cooper Holdings Bhd made a loan of RM10 million to Cooper Electrical Bhd, for the purposes of it looking to expand its geographical spread. Cooper Electrical Bhd now has operations in several South-east Asian countries.
- Cooper Holdings Bhd acquired equity shareholdings in two associate companies - Plant Machinery Bhd and Plant Hire Bhd.
- Cooper Holdings Bhd directly purchased a major high-technology plant costing RM5 million in 2022. This plant is expected to give technological advantages for the company and drive significant increased efficiency for them for the next 5 years, at which point further investment would be required.

REQUIRED:

- (a) Explain how the principles for consolidating financial statements would apply to Cooper Holdings Bhd when preparing its 2022 group financial statements.

(15 marks)

- (b) Outline the issues for accounting for the high-technology plant that Cooper Holdings Bhd purchased in 2022.

(10 marks)

[Total for Question 8 = 25 marks]

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Question 9

Danilo Berhad (“Danilo”) is a manufacturing company, which produces major items of engineering plant for selling to several global industrial customers. In order to manufacture the engineering plant Danilo requires multiple component parts to be available at its own plant. These component parts vary significantly in size, complexity and cost, and the effective management of these inventory items, and the manufacturing process, is business critical to Danilo.

Danilo’s summarised statements of financial position are as follows:

Statements of financial position as at 31 December		
	2022	2021
	RM million	RM million
ASSETS		
Total Non-current assets	167	156
Current assets		
Inventories	55	43
Trade receivables	35	44
Cash and cash equivalents	6	4
Total current assets	96	91
Total assets	<u>263</u>	<u>247</u>
EQUITY AND LIABILITIES		
Total equity	100	105
Total Non-current liabilities	78	78
Current liabilities		
Trade payables	63	52
Taxation	22	12
Total current liabilities	85	64
Total liabilities	163	142
Total equity and liabilities	<u>263</u>	<u>247</u>

Additional information	2022	2021
Revenue	RM333 million	RM340 million
Gross profit	RM84 million	RM92 million
Credit sales as a % of sales	92%	94%
Credit purchases as a % of purchases	100%	100%

REQUIRED:

(a) Calculate the working capital cycle (in days) for Danilo for both years.

(10 marks)

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- (b) Analyse the methods of inventory management that Danilo might use, as a manufacturing company, to improve its own inventory management.

(10 marks)

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- (c) Explain the two main alternatives identified in the Malaysian Accounting Standards Board's Conceptual Framework for Financial Reporting for measuring the elements included in the statements of financial position for Danilo.

(5 marks)

[Total for Question 9 = 25 marks]

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TOTAL FOR SECTION C = 50 MARKS

TOTAL FOR PAPER = 100 MARKS

The scenarios included here are entirely fictional. Any resemblance of the information in the scenarios to real persons or organisations, actual or perceived, is purely coincidental.

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