THE INSTITUTE OF COST AND MANAGEMENT ACCOUNTANTS OF BANGLADESH
CMA DECEMBER, 2017 EXAMINATION
MANAGEMENT LEVEL
SUBJECT: F2. FINANCIAL MANAGEMENT

Time: Three hours | Full Marks: 100

- All questions are to be attempted.
- Show computations, where necessary.
- Answer must be brief, relevant, neat and clean.
- Start answering each question from a fresh sheet.

PART – A: [Q. No. 1 – 4]: (20 MARKS)

Q. No. 1

LP issued 4 million Tk. 1 cumulative redeemable preference shares on 1 April 2012 at their par value. The shares carry a fixed coupon rate of 6%, which is payable annually in arrears. They are redeemable on 31 March 2016 at a premium of Tk. 300,000. LP incurred a transaction cost on 1 April 2012 of 1% of the issue proceeds. The effective interest rate associated with the shares is approximately 7.97%.

Required:

(i) Prepare the journal entries to record the issue of the shares and the associated transaction costs; and

(ii) Calculate the carrying value of the preference shares to be included in LP's statement of financial position as at 31 March 2013.

[Marks: 5]

Q. No. 2

NDB granted 1,000 share appreciation rights (SARs) to each of its 5,000 employees on 1 July 2012. To be eligible for the rights, employees must remain with the entity for 3 years from the grant date. The rights can be exercised in the two months following the end of the vesting period, with settlement due in cash.

In the year to 30 June 2013, 80 employees left and a further 130 were expected to leave over the following two years.

The fair value of each SAR was Tk. 8 at 1 July 2012 and Tk. 9 at 30 June 2013.

Required:

In accordance with IFRS 2 *Share-based Payment:*

(i) Prepare the journal entry to record the expense associated with the SARs in NDB's financial statements for the year to 30 June 2013; and

(ii) Explain how the recognition and measurement of a share-based payment would differ if it was to be settled in equity rather than cash.

[Marks: 5]

Q. No. 3

IFRS 13 *Fair Value Measurement* sets out a framework for the measurement of fair value. It has established a hierarchy that categorizes the inputs used in valuation techniques. Level 1 and level 2 inputs are both included in that hierarchy.

Required:

Explain, in accordance with IFRS 13 *Fair Value Measurement*, what could be used to establish the fair value of an equity investment that would constitute:

(i) A level 1 input; and

(ii) A level 2 input.

[Marks: 5]

Q. No. 4

RT operates a defined benefit pension plan for its employees. At 1 July 2011 the fair value of the pension plan assets was Tk. 2,200,000 and the present value of the pension plan liabilities was Tk. 2,400,000. The interest cost on the pension plan liabilities was estimated at 8% and the expected return on pension plan assets at 5%.

The actuary estimates that the current service cost for the year ended 30 June 2012 is Tk. 500,000. RT made contributions into the pension plan of Tk. 300,000 and the pension plan paid Tk. 450,000 to retired members in the year to 30 June 2012. At 30 June 2012 the fair value of the pension plan assets was Tk. 2,300,000 and the present value of the pension plan liabilities was Tk. 2,700,000.

Actuarial gains and losses are included within the other comprehensive income of RT as incurred.

Required:

(i) Calculate the net expense that will be included in RT's profit or loss for the year ended 30 June 2012, in accordance with IAS 19 Employee benefits.

(ii) Calculate the amount that will be included in RT's other comprehensive income for the year ended 30 June 2012, in accordance with IAS 19 Employee benefits.

[Marks: 5]

PART – B: [Q. No. 5– 7]: (30 MARKS)

Q. No. 5

On 1 February 2014, CB, a listed entity, had 3,000,000 ordinary shares in issue. On 1 March 2014, CB made a rights issue of 1 for 4 at Tk.6.50 per share. The issue was completely taken up by the shareholders.

Extracts from CB's financial statements for the year ended 31 January 2015 are presented below:

CB: Extracts from income statement for the year ended 31 January 2015

	Taka '000
Operating profit	1,380
Interest payable	(400)
Profit before tax	980
Income tax	(255)
Profit for the period	725

CB: Extracts from summarized statement of changes in equity for the year ended 31 January 2015

	Taka '000
Balance as at 1 February 2014	7,860
Issue of share capital	4,875
Surplus on revaluation of properties	900
Profit for the period	725
Ordinary dividends	(300)
Balance as at 31 January 2015	14,060

Just before the rights issue, CB's share price was Tk.7.5, rising to Tk.8.25 immediately afterwards. The share price at close of business on 31 January 2015 was Tk.6.25.

At the beginning of February 2015 the average price earnings (P/E) ratio in CB's business sector was 28.4, and the P/E of its principal competitor was 42.5.

Q. No. 5 (cont'd……..)

Required:

(i) Calculate the earnings per share for CB for the year ended 31 January 2015, and its P/E ratio at that date.

(ii) Explain the significance of P/E ratios to investors, and compare CB's P/E ratio relative to those of its competitor and industry sector.

[Marks: (7+3) = 10]

Q. No. 6

The following information relates to two share-based transactions that LM entered into in 20X6.

(i) LM granted share options to its 200 employees on 1 January 20X6. Each employee will receive 500 share options if they continue to work for LM for the next three years. The fair value of the options at the grant date was Tk.2.00 each.

(ii) LM operates an incentive scheme for its employees which it set up during 20X6. Under the terms of the scheme the workforce will be offered 80% of the share price increase on 10,000 of the entity's shares. Payment will be made on 31 March 20X9. Again the scheme is only open to those who remain employed with LM for the three year period. The fair value of the LM share at the end of the each of the three years is:

20X6- Tk.1.60
20X7- Tk.1.80
20X8- Tk.2.10

During 20X6 20 employees left and another 45 were expected to leave over the next two years.
During 20X7 15 employees left and another 20 were expected to leave in 20X8.
During 20X8 10 employees left.

Required:

Briefly describe the accounting treatment to be adopted for these transactions, in accordance with IFRS 2 Share-based payment and calculate the amount to be recorded in the income statement for staff costs in respect of each of the three years.

[Marks: 10]

Q. No. 7

SR is a service-based entity, listed on its local stock exchange, which relies on its human resources to generate revenue. The directors believe that the information provided by the annual financial report fails to provide a complete picture of the resources available to the entity. They are keen to ensure that current and potential investors are aware of the investment the entity has made in its employees and are considering including a narrative report in respect of human capital.

Required:

(i) Discuss, referring specifically to the recognition principles of the IASB's Framework for the Preparation and Presentation of Financial Statements, why human resources cannot be recognized as an asset in the financial statements of SR.

(ii) Discuss the pressures in the current economic climate to extend narrative reporting in corporate reports AND the potential advantages that could be gained by investors if SR included voluntary narrative disclosures specifically in respect of human capital.

[Marks: (5+5) = 10]

PART – C: [Q. No. 8– 9]: (50 MARKS)

Q. No. 8

On 1 October 2015 Prodigal purchased 75% of the equity shares in Sentinel. The acquisition was through a share exchange of two shares in Prodigal for every three shares in Sentinel. The stock market price of Prodigal's shares at 1 October 2015 was Tk.4 per share.
The summarized statements of comprehensive income for the two companies for the year ended 31 March 2016 are:

	Prodigal (Tk.'000)	Sentinel (Tk.'000)
Revenue	450,000	240,000
Cost of sales	(260,000)	(110,000)
Gross profit	190,000	130,000
Distribution costs	(23,600)	(12,000)
Administrative expenses	(27,000)	(23,000)
Finance costs	(1,500)	(1,200)
Profit before tax	137,900	93,800
Income tax expense	(48,000)	(27,800)
Profit for the year	89,900	66,000
Other comprehensive income		
Gain on revaluation of land (note (i)	2,500	1,000
Loss on fair value of equity financial asset investment	(700)	(400)
	1,800	600
Total comprehensive income	91,700	66,600

The following information for the equity of the companies at **1 April 2015** (i.e. before the share exchange took place) is available:

	Tk'000	Tk.'000
Equity shares of Tk.1 each	250,000	160,000
Share premium	100,000	Nil
Revaluation reserve (land)	8,400	Nil
Other equity reserve	3,200	2,200
Retained earnings	90,000	125,000

The following information is relevant:

(i) Prodigal's policy is to revalue the group's land to market value at the end of each accounting period. Prior to its acquisition Sentinel's land had been valued at historical cost. During the post acquisition period, Sentinel's land had increased in value over its value at the date of acquisition by Tk.1 million. Sentinel has recognized the revaluation within its own financial statements.

(ii) Immediately after the acquisition of Sentinel on 1 October 2015, Prodigal transferred an item of plant with a carrying amount of Tk.4 million to Sentinel at an agreed value of Tk.5 million. At this date the plant had a remaining life of two and half years. Prodigal had included the profit on this transfer as a reduction in its depreciation costs. All depreciation is charged to cost of sales.

Q. No. 8 (cont'd……..)

(iii) After the acquisition, Sentinel sold goods to Prodigal for Tk.40 million. These goods had cost Sentinel Tk.30 million. Tk.12 million of the goods sold remained in Prodigal's closing inventory.

(iv) Prodigal's policy is to value the non-controlling interest of Sentinel at the date of acquisition at its fair value which the directors determined to be Tk.100 million.

(v) The goodwill of Sentinel has not suffered any impairment.

(vi) All items in the above statements of comprehensive income are deemed to accrue evenly over the year unless otherwise indicated.

Required:

(i) Prepare the consolidated statement of comprehensive income of Prodigal for the year ended 31 March 2016;

(ii) Calculate the total equity section (including the non-controlling interest) that would be included in the consolidated statement of financial position of Prodigal as at 31 March 2016.

Note: You are NOT required to calculate consolidated goodwill or produce the statement of changes in equity.

[Marks: (18+7) = 25]

Q. No. 9

PPP, a listed entity, supplies, installs and maintains burglar alarm systems for business clients. As a response to increased competition and falling margins in the burglar alarm market, the entity's directors decided, towards the end of 2015, to extend its operations into the provision of fire alarm and sprinkler systems. A training programme for staff was undertaken in the early months of 2016 at a cost of around Tk.200,000. An aggressive marketing campaign, costing Tk.250,000, was launched at the same time. Both costs were incurred and settled before the 31 March 2016 year end. PPP commenced its new operation with effect from the beginning of its financial year on 1 April 2016.

PPP's cash resources were at a low level in early 2016, so, in order to finance the costs of the new operation and the necessary increase in working capital to fund the new operations, PPP made a new issue of shares. The issue took place in May 2016. During March 2017, PPP disposed of its two overseas subsidiaries in order to concentrate on operations in its home market. Both were profitable businesses and therefore sold for an amount substantially in excess of carrying value. These subsidiaries accounted for almost 10% of group sales during the 2016/2017 financial years.

As the finance director's assistant you have been responsible for the preparation of the draft financial statements, which have been circulated to the directors in advance of a board meeting to be held later this week.

The marketing director, who was appointed in June 2016, has sent the following e-mail:

'When I did my university course in marketing I studied a module in finance and accounting, which covered the analysis of financial statements. Unfortunately, it was a long time ago, and I've forgotten quite a lot about it.

I'm puzzled by the statement of cash flows, in particular. The income statement shows a loss, which is obviously bad news, especially as the budget showed a profit for the year. However, the cash resources of the business have actually increased by quite a large amount between March 20X6 and March 20X7. It is said that "cash is king", So I'm assuming that the poor profitability is a short-term problem while the new operation settles down.

Q. No. 9 (cont'd……..)

As you know, we almost managed to achieve our sales targets in both the fire and burglar alarm sectors for the year, (although of course we did have to offer some customers special discounts and extended credit as inducements). I'm assuming, therefore, that the lack of profitability is a problem of cost control.

It would be really helpful if you could provide me with a brief report, in advance of this week's meeting, which tells me what this statement of cash flows means. You could include ratios, provided that you show how they are calculated.'

The consolidated statement of cash flows for the year ended 31 March 2017 (with comparative figures for 20X6) is as follows:

PPP: Consolidated statement of cash flows for the year ended 31 March 2017

	2017 Tk.000	**2017 Tk.000**	**2016 Tk.000**	**2016 Tk.000**
Cash flows from operating activities				
(Loss)/profit before tax	(453)		306	
Adjustments for:				
Depreciation	98		75	
Foreign exchange loss	22		37	
Profit on sale of investments	(667)		-	
Interest expense	161		45	
		(839)		463
Increase in inventories		(227)		(65)
Increase in receivables		(242)		(36)
Increase in payables		62		12
Cash (outflow)/inflow from operations		(1,246)		374
Interest paid		(157)		(42)
Tax paid		(38)		(55))
Net cash (outflow)/inflow from operating activities		(1,441)		277
Cash flows from investing activities				
Proceed from sale of investments	2,320		-	
Purchase of property, plant and equipment	(661)		(425)	
Income from associates	23		26	
Net cash inflow/(outflow) from financing activities		1,682		(399)
Cash flows from financing activities				
Proceeds from issue of share capital	850		-	
Dividend paid	-		(200)	
Net cash inflow/(outflow) from financing activities		850		(200)
Net increase/(decrease) in cash		1,091		(322)
Cash at start of period		27		349
Cash at end of period		1,118		27

Q. No. 9 (cont'd……..)

Additional information:

Revenue in the 2015/2016 financial year was Tk.12.11 million. In the 2016/2017 financial year, total revenue was Tk.12.32 million, Tk.10.93 million of which arose in respect of the sale of burglar alarms.

Inventories at the start of the 2015/2016 financial year were Tk.591,000, and receivables were Tk.1,578,000. There was no increase in long-term borrowing throughout the two year period covered by the cash flow statement above.

Required:

Analyze and interpret the information given, and produce a report to the marketing director. The report should explain:

(i) Difference between cash and profit;

(ii) Business's profitability;

(iii) Working capital position;

(iv) The prospects for PPP's future to the extent possible from the information given.

[Marks: 25]

= THE END =