**CMA JUNE, 2019 EXAMINATION**
**MANAGEMENT LEVEL**
**SUBJECT: F2. FINANCIAL MANAGEMENT**

Time Allocated: Three hours | Total Marks: 100

**Instructions to Candidates**

| |
|---|
| There are three sections (that is A, B & C) in this paper. You are required to answer ALL questions. |
| Answers should be properly structured, relevant and computations need to be shown wherever necessary. |
| You are strongly advised to carefully read ALL the question requirements before attempting the question concerned (that is all parts and/or sub-questions). |
| Start answering each question from a fresh sheet. Your answers should be clearly numbered with the sub-question number then ruled off, so that the markers know which sub-question you are answering. |

| Section | No of questions in the Section | No of sub-questions in the Section | Marks allocation |
|---|---|---|---|
| A | 01 | 08 | 20% |
| B | 01 | 05 | 30% |
| C | 02 | | 50% |

**TURN OVER**

## SECTION A – 20 MARKS

This section consists of 1 question and 8 sub-questions.
You are advised to spend no longer than 36 minutes on this section. Section will carry 20 marks and one sub-question will carry 2.5 marks each.

**Question No. 1**

(a) On September 1, 2015, WXY Corporation acquired AXY for a cash payment of Tk.700,000. At the time of purchase, AXY's statement of financial position showed assets of Tk.620,000, liabilities of Tk.200,000, and equity of Tk.420,000. The fair value of AXY's asset is estimated to be Tk.800,000. Compute the amount of goodwill acquired by WXY.

**(2½ Marks)**

(b) What constitutes "significance influence" when an investor's financial interest is below the 50% level?

**(2½ Marks)**

(c) Earnings per share can affect market prices of ordinary shares. Can market prices affect earnings per share? Explain.

**(2½ Marks)**

(d) An entity's benefit plan pays certain benefits according to the following rules.

* To those who leave employment before completing five years of service – nil;
* To those who leave employment after completing five years of service but before completing 20years of service – at the rate of 10% of a specified sum; and
* To those who leave employment after completing 20 years of service – at the rate of 25% of a specified sum.

The entity estimates that 20% of staff will leave before completing five years of service and another 65% before completing 20 years of service.

**Required:**

How should benefit be attributed?

**(2½ Marks)**

(e) Preference share is treated as financial liability. Do you agree? Why or why not? Explain.

**(2½ Marks)**

(f) Trans Ltd. acquired 60% of the share capital of Hessen Ltd. on 31 March 2016. The share capital and retained earnings of Hessen Ltd. as on 31 December 2016 were as follows.

| | |
|---|---|
| Ordinary Tk. 0.25 shares | Tk. 4, 00,000 |
| Retained earnings at 1 January 2016 | Tk. 1, 20,000 |
| Net Profit for 2016 | Tk. 60,000 |

The profits of Hessen Ltd. have been accrued evenly throughout 2016. The discount on acquisition was Tk. 3,000. What is the cost of investment in Hessen Ltd. in the balance sheet of Trans Ltd. as on 31 December 2016?

**(2½ Marks)**

(g) On 15 November, 2016, a UK entity imported some plant and equipment costing $400,000 from an USA supplier, with Tk.250,000 being paid on 31 December, 2016 and $150,000 being paid on 31 January 2017.

The $/£ spot exchange rates were as follows.

| | $/£ |
|---|---|
| 15 November 2016 | 2.0:1 |
| 31 December 2016 | 1.9:1 |
| 31 January 2017 | 1.8:1 |

How should these transactions be reported within the statement of cash flows?

**(2½ Marks)**

(h) State the three widely used valuation techniques mentioned in IFRS 13- Fair value Measurement.

**(2½ Marks)**

***END OF SECTION A,* SECTION B Starts on page 3**

**SECTION B**

This section consists of 1 question and 5 sub-questions.

You are advised to spend no longer than 9 minutes on each sub-question in this section. Section will carry 30 marks and one sub-question will carry 6 marks each.

**Question No. 2**

(a) CXY operates a defined benefit pension plan for its employees. At 1 April 2017 the fair value of the pension plan assets was Tk.8,200,000 and the present value of the pension plan liabilities was Tk.8,500,000.

The actuary estimated that the service cost for the year to 31 March 2018 was Tk.2,100,000. The pension plan paid Tk.500,000 to retired members and CXY paid TK.1,900,000 in contributions to the pension plan in the year to 31 March 2018. The actuary estimated that the relevant discount rate for the year to 31 March 2018 was 6%.

On 31 March 2018 CXY announced improvements to the benefit offered by the pension plan to all of its members. The actuary estimated that the past service cost associated with these improvements was Tk.2 million.

At 31 March 2018 the fair value of the pension plan assets was Tk.10,200,000 and the present value of the pension plan liabilities (including the past service costs) was Tk.12,500,000.

**Required:**

In accordance with IAS 19 *Employee Benefits:*

(i) Calculate the net actuarial gain or loss (stating which) that will be included in CXY's other comprehensive income for the year ended 31 March 2018.

(ii) Calculate the net pension asset or liability (stating which) that will be included in CXY's statement of financial position as at March 2018.

(b) Endeavour, a public limited company, trades in six business areas which are reported separately in its internal accounts provided to the chief operating decision maker. The results of these segments for the year ended 31 December 20X5 are as follows.

**Operating segment information as at 31 December 20X5**

| | Revenue | | | Segment Profit/loss | Segment Assets | Segment Liabilities |
|---|---|---|---|---|---|---|
| | **External** | **Internal** | **Total** | | | |
| | £m | £m | £m | £m | £m | £m |
| Chemicals: | | | | | | |
| Europe | 14 | 7 | 21 | 1 | 31 | 14 |
| Rest of world | 56 | 3 | 59 | 13 | 78 | 34 |
| Pharmaceuticals wholesale | 59 | 8 | 67 | 9 | 104 | 35 |
| Pharmaceuticals retail | 22 | 0 | 22 | (2) | 30 | 12 |
| Cosmetics | 12 | 3 | 15 | 2 | 18 | 10 |
| Hair Care | 11 | 1 | 12 | 4 | 21 | 8 |
| Body care | 18 | 24 | 42 | (6) | 54 | 19 |
| | 192 | 46 | 238 | 21 | 336 | 132 |

**Required:**

Which of the operating segments of Endeavour constitute a 'reportable' operating segment under IFRS 8 *Operating Segments* for the year ending 31 December 20X5?

**SECTION B Continues on page 4**

(c) Lemon Ltd prepares its financial statements to 31 December each year. On 1 January 2013, Lemon had ten million $0.50 pr shares in issue and on July 1 2013 made a 1 for 5 rights issue at a price of $1.2 per share. The market price of a Lemon share immediately before the right issue was $1.50. Earnings for the year ended 31 December 2013 were $4,697,000.

Lemon Ltd also has in issue $3,200,000 of 6% convertible redeemable loan stock with the following terms of conversion for every $100 of loan stock.

Conversion at 31 December 2014 108 shares.
Conversion at 31 December 2015 104 shares.

The liability component of the convertible redeemable loan stock was carried in the statement of financial position on 1 January 2013 at $3 million and the effective interest rate is 9%.

Lemon Ltd. pays tax at a rate of 30%.

**Required:**

(i) Calculate basic and diluted EPS for the year ended 31 December 2013.

(ii) Explain to a holder of Lemon Ltd. shares both the usefulness and limitations of the diluted EPS figure.

(d) The summarised accounts of CamrumiteInc are shown below.

STATEMENT OF FINANCIAL POSITION AS AT 31 DECEMBER 20X3

| | € |
|---|---|
| Non-current assets | 10,000 |
| Net monetary assets | 5,000 |
| | 15,000 |
| Equity | |
| Ordinary share capital and reserves | 15,000 |

INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 20X3

| | € |
|---|---|
| Profit after tax | 3,080 |
| Dividend payable | 1,680 |
| Retained profit | 1,400 |

60% of the issued capital of CamrumiteInc is owned by Bates Co, a company based in the UK.

There have been no movements in long-term assets during the year.

The exchange rate has moved as follows.
1 January 20X3 € 5 = £1
Average for the year ended 31.12.X3 € 7 = £1
31 December 20X3 € 8 = £1

**Required:**

You are required to calculate the figures for the non-controlling interest to be included in the consolidated accounts of Bates Co. The non-controlling interest is measured using the proportion of net assets method. Show the movements on the non-controlling interest accounts during the year.

(e) When performing an analytical review of financial statements of listed entities, the following key indicators are often used:

- Gross margin
- Profit margin (profit for the year/revenue)
- P/E ratio
- Gearing (Long term borrowings/equity)

**Required:**

Discuss, with specific reference to the four ratios above, the extent to which entities within the same business sector can be validly compared with each other. (6)

***END OF SECTION B***

**SECTION C Starts on page 5**

**Section C**

This section consists of 2 questions.

You are advised to spend no longer than 45 minutes on each question in this section. Section will carry 50 marks and allocation of marks for each question and sub-question is indicated next to the sub-question.

**Question No. 3**

Extracts from the draft financial statements of BX, Y and Z are presented below.

| Statements of financial position as at 31 March 2014 | BX (Taka) | Y (Taka) | Z (Taka) |
|---|---|---|---|
| **ASSETS** | | | |
| **Non-current assets** | | | |
| Property, plant and equipment | 210 | 88 | 110 |
| Investment in Y | 148 | - | - |
| Investment in Z | - | 76 | - |
| | 358 | 164 | 110 |
| **Current assets** | 60 | 46 | 28 |
| **Total assets** | 418 | 210 | 138 |
| **EQUITY AND LIABILITIES** | | | |
| **Equity attributable to owners of the parent** | | | |
| Share capital (Tk.1 equity shares) | 200 | 80 | 60 |
| Share premium | 50 | 20 | 10 |
| Other reserves | 18 | 6 | - |
| Retained earnings | 65 | 60 | 46 |
| **Total equity** | 333 | 166 | 116 |
| **Non-current liabilities** | 25 | 10 | 4 |
| **Current liabilities** | 60 | 34 | 18 |
| **Total liabilities** | 85 | 44 | 22 |
| **Total equity and liabilities** | 418 | 210 | 138 |

**Additional information:**

1. BX acquired 75% of the equity share capital of Y on 1 April 2011 when the retained earnings of Y were Tk.45 million and the balance on Y's other reserves was nil. This acquisition resulted in BX having power over Y which when exercised affects its return from the investment. Y has not issued any shares since the acquisition date. The non-controlling interest in Y was valued at fair value at the date of acquisition. The fair value of one equity share in Y was Tk.2.00 on 1 April 2011.

   The fair value of the net assets of Y was deemed to be the same as the carrying value at the date of acquisition with one exception. A contingent liability which could be reliably measured, had a fair value of Tk.5 million at the date of acquisition and a fair value of Tk.2 million at 31 March 2014.
2. Y acquired 80% of the equity share capital of Z on 1 January 2012 when the retained earnings of Z were Tk.20 million and the balance on Z's other reserves was nil. This acquisition resulted in Y having power over Z which when exercised affects its return from the investment. Z has not issued any shares since the acquisition date. The non-controlling interest in Z was valued at fair value at the date of acquisition. The fair value of one equity share in Z was Tk.1.75 on 1 January 2012.
3. BX concluded that the goodwill on the acquisition of Y was impaired by 20% on 31 March 2014. No other impairments of goodwill have arisen.
4. The balance on "other reserves" for both BX and Y relate solely to movements in the values of their investments in Y and Z respectively.

**SECTION C Continues on page 6**

5. BX issued a debt instrument on 1 April 2013 at its nominal value of Tk.25,000,000. The instrument carries a fixed coupon interest rate of 5.5%, which is payable annually in arrears. The loan is repayable at a premium in 7 years time. Transaction costs of Tk.250,000 were paid on the issue of the debt instrument and charged to administrative expenses. The effective interest rate applicable to this instrument has been calculated at approximately 9.5%. The interest due was paid in March 2014.

**Required:**

Prepare the consolidated statement of financial position for the BX group as at 31 March 2014.

**[Marks: 25]**

**Question No. 4**

You have been approached by a friend who is considering investing in EEE, a fast growing entity that has had significant positive media coverage in the last year. Your friend performed a brief review of the financial statements and sent you this message:

"I am concerned that EEE appears to have invested heavily in property, plant and equipment in the year, which seems to have resulted in an overdraft at the year end. Is this an indication of poor management? I am a little confused because everything I have read about this entity and its management has been positive and its share price increased significantly from Tk.5.08 on 31 December 2017 to Tk.9.27 on December 2018."

EEE paid a dividend of Tk.50 million in 2018 (Tk.100 million in 2017)

The financial statements of EEE are provided below:

| Statement of financial position as at 31 December | 2018 (Tk. million) | 2017 (Tk. million) |
|---|---|---|
| **ASSETS** | | |
| **Non-current assets** | | |
| Property, plant and equipment | 766 | 448 |
| Available for sale investments | 298 | 280 |
| | 1,064 | 728 |
| **Current assets** | | |
| Inventories | 290 | 130 |
| Receivables | 468 | 402 |
| Cash and cash equivalents | - | 144 |
| Total assets | 758 | 676 |
| **Total assets** | 1,822 | 1,404 |
| **EQUITY AND LIABILITIES** | | |
| **Equity** | | |
| Share capital (Tk.1 equity shares) | 300 | 300 |
| Revaluation reserve | 155 | 75 |
| Other reserves | 66 | 44 |
| Retained earnings | 801 | 633 |
| **Total equity** | 1,322 | 1,052 |
| Non-current liabilities | | |
| 5% convertible borrowings, 2014 | 200 | 188 |
| Deferred tax | 43 | 30 |
| | 243 | 218 |
| Current liabilities | | |
| Payables | 199 | 134 |
| Short-term borrowings (note 1) | 58 | - |
| | 257 | 134 |
| Total liabilities | 500 | 352 |
| Total equity and liabilities | 1,822 | 1,404 |

**SECTION C Continues on page 7**

| Statement of comprehensive income for the year ended 31 December | 2018 (Tk. Million) | 2017 (Tk. Million) |
|---|---|---|
| **Revenue** | 2,400 | 2,020 |
| Cost of sales | (1,735) | (1,505) |
| Gross Profit | 665 | 515 |
| Administrative expenses | (144) | (103) |
| Distribution costs | (287) | (220) |
| Finance costs | (20) | (6) |
| Investment income | 94 | - |
| **Profit before tax** | 308 | 186 |
| Income tax expense | (90) | (60) |
| **Profit for the year** | 218 | 126 |
| *Other comprehensive income that will not be reclassified to profit or loss* | | |
| Revaluation gain on property, plant and equipment | 100 | 25 |
| Other comprehensive income that may be reclassified to profit or loss | | |
| Gains on available for sale investments | 30 | 12 |
| Tax effects of other comprehensive income | (28) | (15) |
| **Other comprehensive income for the year, net of tax** | 102 | 22 |
| **Total comprehensive income** | 320 | 148 |

**Note 1**

In September 2018 EEE secured a short term overdraft-facility of up to Tk.80 million for nine months. The directors submitted an application for long term borrowings of Tk.100 million in November 2018. The directors were awaiting a response from the lender at the year end.

**Required:**

(a) Analyze the financial performance of EEE for the year ended 31 December 2018 and its financial position at that date. Your analysis should have as its primary focus the areas that would be of particular relevance to a potential investor.
The convertible borrowings are due for conversion or redemption in December 2020.

(b) Explain the impact on the investor ratios if the majority of the holders choose to convert to equity shares.

**[Marks: (20+5) = 25]**

***End of the Exam Paper***