Diploma in Financial Management

PAPER DA1, INCORPORATING SUBJECT AREAS
– **INTERPRETATION OF FINANCIAL STATEMENTS**
– **PERFORMANCE MANAGEMENT**

MONDAY 2 JUNE 2003

QUESTION PAPER

Time allowed **3 hours**

This paper is divided into three sections

Section A	ALL 20 questions are compulsory and MUST be answered
Section B and Section C	THREE questions in total to be answered. Candidates MUST answer ONE question from Section B, ONE question from Section C and ONE further question from either Section B or Section C.

Module A

Section A – All 20 questions are compulsory and MUST be attempted
Each question within this Section is worth 2 marks.
Please use the Candidate Registration Sheet provided to indicate your chosen answer to each multiple choice question.

1 The Companies Acts specify that every limited company must prepare annual Financial Statements.

Who is specifically charged with this responsibility?

A The Financial Director
B The Shareholders
C The Auditors
D The Board of Directors

2 **Which one of the following groups is responsible for issuing Financial Reporting Standards (FRSs)?**

A Financial Reporting Council
B Urgent Issues Task Force
C Accounting Standards Board
D Financial Reporting Review Panel

3 In the current financial year, Natamo Ltd has raised a loan for £3m. The loan is repayable in 10 equal half yearly instalments. The first instalment is due six months after the loan was raised.

How will the loan be reported in Natamo's next financial statements?

A as a current liability
B as a long term liability
C as capital
D as both a current and a long term liability

4 Chartwell Ltd has in issue 120,000 Ordinary shares of £1 each and 10,000 6% Preference shares of £3 each.

An abridged Profit and Loss Account for the year to 31 March 2003 is shown below:

	£	£
Profit before interest and tax		528,934
Interest paid		6,578
Profit before tax		522,356
Taxation		125,860
Profit after tax		396,496
Dividends: Ordinary	10,800	
Preference	1,800	12,600
Retained profit for year		383,896

What figure should be reported as basic earnings per share as defined in FRS 14?

A 319·9p
B 328·9p
C 330·4p
D 435·3p

5 Groomers plc took delivery of a machine on 1 May 2003. The invoice shows the following information:

		£
Model XY54		124,760
Delivery		1,250
Installation		3,750
Maintenance	1/5/03 – 30/4/04	2,500

At what cost (i.e. before depreciation) will the machine be carried in Groomers plc's balance sheet?

A £124,760
B £126,010
C £129,760
D £132,260

6 The Balance Sheet of Jardino Ltd includes the following information:

	£
Fixed Assets	219,650
Current Assets	124,800
Current Liabilities	64,290

What is the value of working capital?

A £ 60,510
B £ 64,290
C £124,800
D £280,160

7 Domino Ltd has just redeemed £625,000 of 4% Redeemable Debentures. The funds for the redemption were raised by issuing Ordinary Shares.

Which one of the following statements correctly describes the effect of these transactions on the company's capital gearing ratio?

A Equity and debt have both increased, thus gearing has not changed
B Equity and debt are unchanged, thus gearing has not changed
C Equity has increased and debt has decreased, thus gearing has decreased
D Equity has decreased and debt has increased, thus gearing has increased

8 When reporting profit for a period, companies are required to ensure that income and expenses are correctly classified.

Which one of the following items will be included in the calculation of operating profit?

A Interest payable
B Reorganisation costs
C Depreciation of fixed assets
D Deferred tax

9 At 30 April 2003 the fixed assets of Shades plc have a net book value of £365,700 and a tax written down value of £220,000. The balance brought forward on the deferred tax account at 1 May 2002 was £33,000. The tax rate is 25%.

What is the balance on the deferred tax account at 30 April 2003? (Ignore discounting)

A £33,000
B £36,425
C £55,000
D £91,425

10 Sculpart is a business which buys and sells original sculptures. One of the items in stock at 31 March 2003 had been bought 4 years ago at a cost of £15,000. It had originally been anticipated that this item would be sold for £22,000. To date the best offer which has been received is £17,500 from an overseas collector. This offer has been made on the basis that the item will be transported to the collector. It is estimated that the costs of shipping and insurance are £3,000.

At what value should this item be included in the stock of Sculpart at 31 March 2003?

A £14,500
B £15,000
C £17,500
D £22,000

11 Which one of the following is UNLIKELY to be the reason for an adverse material price variance?

A the budget incorporated an assumption of price inflation of 4% and the actual rate is 6%
B to reduce waste, a higher grade of material has been purchased
C a major supplier has introduced a rebate scheme which had not been planned for
D an inexperienced purchase clerk ordered materials from four different suppliers

12 Which one of the following statements describe the maximin decision rule?

A select the alternative which has the best payoff
B select the alternative which has the worst payoff
C select the alternative which has the worst of the best payoffs
D select the alternative which has the best of the worst payoffs

13 Ardvec makes 4 products which sell in roughly equal volume. Data in respect of each product is shown below:

Per unit	Economy	Standard	Premium	Deluxe
Selling price	£28·92	£32·83	£37·33	£40·08
Variable cost	£13·92	£16·83	£20·33	£22·08
Direct labour hours	0·17	0·22	0·28	0·31

In the coming period, a shortage of direct labour means that Ardvec can only manufacture three products.

In order to maximise short term profit which product should NOT be produced?

A Economy
B Standard
C Premium
D Deluxe

14 A division manufacturing a single product which sells for £325 has the following unit cost structure:

	£
Direct materials	95
Direct labour	78
Variable overheads	56
Share of fixed costs	45
Total cost	274

In the coming period, the budgeted production volume is 10,000 units.

What is the budgeted breakeven sales volume (to the nearest unit)?

A 1,385 units
B 4,688 units
C 8,824 units
D 10,000 units

15 **Which one of the following statements is NOT correct?**

A A flexible budget allows managers to plan for alternative contingencies
B A flexible budget makes no differentiation between fixed and variable costs
C A flexible budget assists in identifying limiting factors
D A flexible budget provides useful control information

16 **Which one of the following items would NOT be included in a cash budget?**

A Capital repayments on loans
B Depreciation charges
C Dividend payments
D Proceeds of sale of fixed assets

17 Consider the following statement:
'We must ensure that the costs of our inputs are as low as possible, that we achieve as much as we can with the resources available and we deliver a public service'.

Which one of the following is best described by this statement?

A Economy
B Effectiveness
C Value for money
D Efficiency

18 A new project is not expected to achieve any sales in the first three months of operation. It is then anticipated that sales of 4,000 units will be achieved in the next month, followed by an increase of 15% on the previous month in each of the next three months. 10% of sales will be for cash with a discount of 5% on the selling price of £90. Credit sales will be on the basis of one month's credit, but it is anticipated that only 65% of credit customers will pay within this time frame, with the remaining customers paying in the following month.

What is the budgeted cash inflow from credit customers in month six?

A £355,590
B £400,820
C £408,329
D £428,490

19 Hightech is a computer hardware repair company. The total overhead costs and labour hours booked to jobs for the last two months have been:

	April	May
Total overhead costs	£107,980	£101,050
Total labour hours	2,560	2,350

What is the variable overhead cost per labour hour?

A £33·00
B £42·18
C £42·57
D £43·00

20 Ulidas plc uses Economic Value Added (EVA) to assess divisional performance. It also has a policy of writing off development costs as they are incurred. In the year to 31 March 2003, one of the divisions has reported a profit of £4,598,784. The division manufactures three products. The development costs, date of launch and expected product life of each product are shown below:

Product	A	B	C
Development costs	£480,000	£590,000	630,000
Date of launch	1 April 2000	1 April 2001	1 April 2002
Expected life	4 years	5 years	3 years

What adjustment to the reported profit is required to calculate the divisional EVA?

A £182,000
B £448,000
C £630,000
D £1,700,000

(40 marks)

Section B – Candidates MUST attempt ONE question from Section B, ONE question from Section C and ONE further question from either Section B or Section C.

1 The retained profit of Cranic Ltd for the year to 30 April 2003 was £146,486, after providing for depreciation of £98,750, taxation of £27,600 and dividends of £27,000. On 1 May 2002 the company redeemed at par all the debentures which had been outstanding and made a new issue of ordinary shares for cash. There had been no disposals of fixed assets during the year.

The balance sheets at 30 April 2003 and 30 April 2002 are shown below.

	2003	2002
	£	£
Fixed Assets	1,065,170	1,028,163
Current Assets		
Stocks	345,057	301,470
Debtors	636,157	598,315
Cash at Bank	1,723	–
	982,937	899,785
Creditors: Amounts falling due within one year		
Creditors and Accruals	334,521	337,150
Taxation	27,600	115,800
Dividends	22,000	15,000
Bank overdraft	–	52,498
	384,121	520,448
Creditors: Amounts falling due after more than one year		
8% Debentures	–	200,000
	1,663,986	1,207,500
Share Capital	900,000	650,000
Share Premium	110,000	50,000
Retained Profit	653,986	507,500
	1,663,986	1,207,500

NB The 2002 figure for creditors and accruals includes £8,000 in respect of debenture interest.

Required:

(a) **Prepare a reconciliation of operating profit to net cash flow from operating activities for Cranic Ltd for the year to 30 April 2003.** (6 marks)

(b) **Prepare a cash flow statement for Cranic Ltd for the year to 30 April 2003.** (6 marks)

(c) **Assume that you are John Neville, a newly appointed Financial Manager with Cranic Ltd. Draft a memo to the financial director summarising the key issues which are highlighted by the cash flow statement.** (8 marks)

(20 marks)

2 You are a non-executive director of BBT Ltd. The full board is due to meet shortly to consider the adoption of the financial statements. You have been made aware of two suggestions which will be discussed at the meeting. You have agreed to provide the meeting with an overview of the generally accepted accounting practice (GAAP) in relation to these suggestions:

(i) The company owns and uses three freehold properties which were acquired on the same date a number of years ago. These are currently recorded at depreciated historical cost. The company has obtained independent valuations which indicate that the properties in Leeds and Cheltenham have increased in value, while the third has suffered a fall in value.

It has been suggested by one of the directors that the company should 'strengthen the balance sheet' by increasing the values at which the Leeds and Cheltenham properties are carried.

(ii) As the long term trend in property prices is upwards, another director has suggested that 'there is no need to charge depreciation on the buildings'.

Required:

In preparation for the meeting of directors, draft briefing notes which explain:

(a) generally accepted accounting practice (GAAP) relating to:

(i) the revaluation of the freehold properties; (8 marks)

(ii) the need to provide for depreciation. (8 marks)

(b) the effect on the financial statements if GAAP is followed with regard to the revaluation of the properties, bearing in mind the views expressed by the directors. (4 marks)

(20 marks)

3 As a Head Office Manager with a bank, one of your roles is providing assistance to field staff via the bank's intranet. When discussing cases with potential borrowers, the field staff will often obtain a copy of the client's financial statements and contact you for an explanation of any issues they are unsure about.

On accessing your e-mails this morning, you find the following enquiry:

I am negotiating with a company which has given me a copy of both the individual company and consolidated financial statements for the year to 31 January 2003.
The individual company balance sheet includes a heading of 'fixed asset investment' of £1,915,000. I have ascertained that this relates to an investment in another company. I expected to see this investment on the consolidated balance sheet, but instead there is a heading 'interest in associate' of £1,935,000.
When I asked about this, I was given the following information:

Date of acquisition	1 February 2002
Number of shares acquired	1·25m
Goodwill is written off over 8 years	
Summary information regarding the investee:	
Issued share capital	£5m (in £1 Ordinary shares)
Share premium	£1m
Retained profit for year	£200,000
Retained profit at 31.1.03	£900,000

This doesn't mean a lot to me, but I don't want to appear ignorant when discussing this proposal with the client. Could you help me by explaining:

- what an associate is
- what the correct accounting treatment is
- how we can tell if the correct treatment has been applied
- why the value has changed from £1,915,000 to £1,935,000

Required:

Draft a reply to the e-mail, which:

(a) (i) defines an associate;

(ii) explains the correct accounting treatment for an associate; and

(iii) indicates whether you agree that the investment meets the criteria for treatment as an associate.
(8 marks)

(b) provides a reconciliation between the two values. (12 marks)
(i.e. the cost of £1,915,000 and the consolidated value of £1,935,000)

(20 marks)

Section C – Candidates must attempt ONE question from Section B, ONE question from Section C and ONE further question from either Section B or Section C.

4 As a business development manager for a retail clothing chain with 45 outlets, you have been asked to participate in an initial seminar on the development of the company's purchasing and stock management processes.

In preparing for the seminar, you have become aware of three likely topics which will be discussed. You have decided to draft notes for your own use at the seminar.

Required:

Prepare brief notes on the following topics which will form a basis for your discussion with colleagues:

(a) the concept of supply chain management; (6 marks)

(b) the benefits and problems of just-in-time purchasing; (8 marks)

(c) how information technology can contribute in these areas. (6 marks)

(20 marks)

5 Autodes Ltd designs, manufactures and sells a range of components for the motor car industry, selling exclusively to car manufacturers. The design team has recently developed and patented a new component for incorporation into any car. The component will greatly improve fuel consumption and reduce emissions of greenhouse gases. Initial trials have been successful and the company is now planning to launch the product. The design team believes that they are at least 24 months ahead of any of their competitors who are currently developing similar products. The product has been developed under the working title 'Autolong'.

You are a consultant to the company and have been tasked with developing a pricing policy for the Autolong. You have gathered the following data for each unit:

Direct Materials:	Code	Quantity	Price
	WZ954	3g	£4·74 per g
	RT429	5g	£6·12 per g
	Other		£5·01 per unit
Direct Labour	1·5 hours at £21 per hour		

Overheads are absorbed on a direct labour hour basis, at £29 per hour.

Costs of developing the Autolong were £3,675,000. Autodes has a policy of recovering development costs within the first three years of a product's life cycle.

Supplies of material WZ954 are limited to 180,000g per annum. Autodes currently uses all of its available supplies in another product which generates a contribution of £15 per unit. Each unit of this product requires 4g of WZ954. (Development costs of this product have been fully recovered).

Product prices are calculated to obtain a 25% profit margin on sales.

A market report indicates that:
– the market is reasonably price sensitive;
– provided the price is not above £225, demand is expected to exceed production capacity;
– introduction of the Autolong will not affect the sales volumes of other products

The Managing Director has also asked you to comment on the suggestion of a Non Executive Director that the Autolong should be priced on a 'more competitive basis, such as market skimming or market penetration'.

Required:

(a) Calculate the price of the Autolong based on the current pricing policy. (8 marks)

(b) In a report to the Managing Director, comment on the Non Executive Director's suggestion, and recommend an initial price for the Autolong. (12 marks)

(20 marks)

6 Localcab is a taxi company which operates a fleet of 100 taxis. The drivers are self employed and provide their own vehicles. Localcab receives 10% of each driver's takings to cover administration and advertising costs, which are £120,000 per annum. The balance of the fares is retained by the driver who is responsible for all the running costs of the vehicle.

An analysis of payments and journeys has indicated that drivers generate income for Localcab at two levels, according to the volume of business. Forty two of the drivers are in the 'higher volume' category, carrying passengers on 350 journeys per week. The rest of the drivers are the 'lower volume' drivers, carrying passengers on 210 journeys per week.

For all drivers, the average fare per journey is £3·70.

Customer comments have indicated that there is a variance in the level of service experienced by customers due to the fact that drivers provide their own vehicles. Localcab has discussed this with the drivers, who have indicated their willingness to consider becoming employees, driving vehicles provided by Localcab.

The partners are considering this business model and believe that the key issue for the drivers will be the weekly wage which they are offered. They are confident that the drivers will accept a weekly wage of £500. They have also stated that their net profit must be increased by at least 20% to reflect the additional risk they will be taking.

They anticipate that introducing a standardised fleet of vehicles will lead to 5 of the drivers currently in the 'lower volume' category moving into the 'higher volume' category.

They wish to evaluate this change, based on the following data:

– Drivers will be entitled to 3 weeks' paid holiday per annum
– Allowance should be made for 1 week sick leave per driver each year
– Payroll costs will be 10% of gross wages
– Administration and advertising costs will increase by 18%
– Vehicles will be acquired on a contract hire basis. The contract will cover insurance, road tax and routine repairs. The cost of the contract, excluding the capital repayments, is £400 per vehicle per month
– Non-routine repairs are expected to be £50 per vehicle per month
– An average journey is 5 miles
– The average fare per journey will remain unchanged
– Fuel costs are 79p per litre
– Fuel consumption will average 7 miles per litre
– Average depreciation on each vehicle will be £2,500 per annum

Required:

(a) Prepare an operating budget for the first year of operation based on the drivers becoming employees. (13 marks)

(b) Indicate the maximum weekly wage which Localcab can pay, while still achieving the partners' profit objective. (7 marks)

(20 marks)

End of Question Paper