Diploma in Financial Management

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

MONDAY 6 JUNE 2005

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.

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

Module A

The Association of Chartered Certified Accountants

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

1 **Which one of the following correctly states the accounting equation?**

A assets = liabilities *plus* opening capital *plus* profit *plus* drawings
B assets = liabilities *minus* opening capital *minus* profit *minus* drawings
C assets = liabilities *minus* opening capital *minus* profit *plus* drawings
D assets = liabilities *plus* opening capital *plus* profit *minus* drawings

2 **Which one of the following is an unrealised gain?**

A interest earned but not yet credited
B rental income received for a future period
C an increase in the value of a fixed asset
D a gain on the sale of shares held in a quoted company

3 **Which of the following items must be included in the Directors' Report?**

(i) the value of any dividend proposed for payment
(ii) the operating profit for the period
(iii) any changes in the principal activities of the company

A (i) and (ii) only
B (i) and (iii) only
C (ii) and (iii) only
D (i), (ii) and (iii)

4 The financial statements of a company may include the following items:

(i) profit from discontinued activities
(ii) exceptional items
(iii) preference dividends
(iv) ordinary dividends

Which of the above items are included in the calculation of the earnings figure when calculating basic earnings per share (as defined by FRS 14 – Earnings per share)?

A (i), (ii) and (iii)
B (i), (iii) and (iv)
C (ii), (iii) and (iv)
D (i), (ii) and (iv)

5 **Which of the following is the basis on which a provision for depreciation is made?**

A accruals
B going concern
C prudence
D historical cost

6 **Who is responsible for issuing Financial Reporting Standards in the UK?**

A The Professional Accountancy Bodies
B The Accounting Standards Board
C The Financial Reporting Council
D The Financial Reporting Review Panel

7 On 20 May 2005 the finance director of Orajee Ltd reported to the Board of Directors that the company's financial statements for the year to 31 March 2005 reported a profit of £3,528,650.

On 26 May 2005 the directors were informed of the following:

– on 25 May 2005 a fire in one of the company's warehouses destroyed stock valued at £350,000. The entire stock was uninsured.
– an insurance claim in respect of stock which was stolen on 2 April 2005 was settled for £250,000. The finance director had anticipated that the claim would be settled for £270,000.

What is the company's reported profit for the year to 31 March 2005 when these events are taken into account?

A £3,128,650
B £3,178,650
C £3,478,650
D £3,528,650

8 During the year to 30 April 2005 Jaunty Ltd had purchased fixed assets which cost £687,000. The company financed the purchases by taking out loans totalling £597,000, and paying the balance by cheque. In addition, fixed assets with a net book value of £75,000 were sold at a loss of £15,000.

What figure will be reported as the outflow for Capital Expenditure in the company's cash flow statement for the year to 30 April 2005?

A £30,000
B £90,000
C £627,000
D £687,000

9 At 1 May 2004 the revaluation reserve of Bloxden plc was £1,257,000. This was in respect of the company's head office.

During the year to 30 April 2005 the value of the head office increased by a further £82,000. In the same period, the company's factory suffered a permanent impairment of £90,000.

What is the value of the revaluation reserve at 30 April 2005?

A £1,167,000
B £1,249,000
C £1,257,000
D £1,339,000

10 At 31 May 2005 a contract with a total value of £4·7 million had accumulated costs of £2·75 million. It was estimated that the cost to complete the contract would be £1·35 million. A total of £3·15 million had been invoiced to the customer and recognised in turnover.

What value will be reported in the contractor's balance sheet for contract work in progress at 31 May 2005?

A nil
B £2·75 million
C £3·35 million
D £4·10 million

11 Nujig Ltd reduced its quality specification for raw materials. The lower quality of materials meant that a batch of products had to be reworked.

What is the most likely effect on the variances for materials usage and labour efficiency?

	Materials usage	Labour efficiency
A	adverse	adverse
B	adverse	favourable
C	favourable	adverse
D	favourable	favourable

The following information refers to questions 12 and 13:

Morava Ltd produces a product which has a variable cost of £28 and a selling price of £39. Budgeted sales and production volumes for the next month are 18,000 units. Budgeted fixed costs are £121,000 per month.

12 What is the margin of safety (expressed in units)?

A 7,000
B 11,000
C 18,000
D 25,000

13 If Morava wishes to generate a profit of £11,000, how many units must be sold?

A 1,000
B 10,000
C 11,000
D 12,000

The following information is relevant to questions 14 and 15:

The directors of Amar Ltd must choose between four mutually exclusive overseas projects. The profit which the company will earn will depend on the level of growth in the overseas economy. The financial director has summarised the outcomes as follows:

Project	Net profit (£000) if economic growth is:		
	Weak	Moderate	Strong
W	(2)	18	28
X	(5)	20	23
Y	(10)	24	29
Z	(20)	21	33

The probabilities of each level of economic growth are estimated to be:

Weak	15%
Moderate	55%
Strong	30%

14 If the directors use expected value as the basis of their decision, which project should they choose?

A W
B X
C Y
D Z

15 If the directors use the maximin decision rule, which project should they choose?

A W
B X
C Y
D Z

16 In recent years, a growing number of companies have implemented activity based costing (ABC) and activity based management (ABM).

Which of these techniques is/are intended solely to achieve cost reduction?

A Both ABC and ABM
B Neither ABC nor ABM
C ABC only
D ABM only

17 The production director of Navan Ltd is planning to introduce just-in-time manufacturing (JIT).

It has been suggested that the following outcomes will occur:

(i) average capacity utilisation will be reduced
(ii) it will be more difficult to respond to changes in customer demand
(iii) quality standards will normally be improved

Which of the identified outcomes is/are likely to occur if JIT is introduced?

A (ii) only
B (i) and (iii) only
C (ii) and (iii) only
D (i), (ii) and (iii)

18 Which of the following outcomes is/are likely to result from the introduction of Business Process Re-engineering?

(i) Staff will become more specialised
(ii) Customer satisfaction levels will be improved

A (i) only
B (ii) only
C (i) and (ii)
D neither (i) nor (ii)

19 Which of the following statements regarding residual income is correct?

A Residual income is calculated by adding back depreciation and deducting the notional interest charge
B Residual income eliminates the effect of accounting policies from the assessment of performance
C Residual income assesses divisional income based on the book value of the investment which has been made
D Residual income does not take the risk of specific projects into account

20 Selu plc has reported a net operating profit after tax of £2,472,000 for the last year. At the year end, the balance sheet showed a net assets value of £20·4 million. The finance director estimates that the replacement value of the net assets is £27·9 million, and that the company's cost of capital is 8·7%.

What is the Economic Value Added (EVA)® for the year?

A £44,700
B £697,200
C £4,246,800
D £4,899,300

(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 **(a)** When accounting for taxation it is important to differentiate between current taxation and deferred taxation.

Required:

(i) explain the accounting treatment of current taxation; (3 marks)

(ii) explain why it is necessary to provide for deferred taxation. (6 marks)

(b) The assistant accountant of Nontor Ltd has prepared the company's draft Balance Sheet at 31 May 2005 as shown below:

	£000	£000
Fixed assets		
Tangible assets		17,500
Fixed asset investments		1,800
		19,300
Current Assets		
Stock	950	
Debtors	1,340	
Cash at bank and on hand	61	
	2,351	
Creditors: amounts falling due within one year	(1,438)	
Net current assets		913
		20,213
Creditors: amounts falling due after more than one year		(5,560)
		14,653
Capital and reserves		
Called up share capital		3,000
Share premium account		2,000
Revaluation reserve		1,530
Profit and loss account		8,123
		14,653

On reviewing the draft balance sheet, the finance director noted that:
- the assistant accountant did not review the provision for deferred tax or provide for the tax charge on the profits for the year to 31 May 2005;
- the taxation charge on the profits for the year to 31 May 2005 is estimated to be £62,000;
- the provision for deferred tax at 31 May 2004 was £107,000 and the assistant accountant has included this amount in the figure for 'Creditors: amounts falling due within one year';
- also included in 'Creditors: amounts falling due within one year' is the £8,000 credit balance on the taxation account. This is the amount remaining after the total liability for the previous year had been paid;
- at 31 May 2005 the tangible fixed assets reported in the balance sheet have a tax written down value of £17,050,000, and the tax rate is 30%.

Required:

(i) Calculate the company's liabilities for deferred tax and current tax at 31 May 2005, and the taxation charge to the profit and loss account for the year to 31 May 2005. (5 marks)

(ii) Redraft the company's balance sheet at 31 May 2005 to include the liabilities for deferred tax and current tax. (6 marks)

(20 marks)

2 An important aspect of determining that financial statements give a true and fair view is ensuring that items are properly classified. In particular, care is needed when dealing with the following categories:

(i) current liabilities
(ii) long term liabilities
(iii) provisions
(as defined in FRS 12 – Provisions, contingent liabilities and contingent assets)
(iv) contingent liabilities
(as defined in FRS 12 – Provisions, contingent liabilities and contingent assets)

Required:

(a) Briefly explain each of the categories (i)–(iv) above and give an example of each. (12 marks)

(b) Indicate how each category should be treated when preparing financial statements. (8 marks)

(20 marks)

3 While every company is legally obliged to prepare financial statements, not all financial statements need to be audited.

This situation has perhaps added to the confusion in many people's minds as to the different responsibilities of company directors and auditors, the purpose of an audit, and what is meant by the comment in an auditor's report that the financial statements give a 'true and fair view'.

Required:

(a) Outline the respective duties of the directors of a company and the company's auditors with regard to the company's financial statements. (6 marks)

(b) Explain why the financial statements of most companies must be audited. (4 marks)

(c) Describe what is meant by the comment in the auditor's report that the financial statements give a 'true and fair view'. (6 marks)

(d) Give two examples of entities that are not required to prepare audited financial statements, and in each case, briefly explain why an audit is not required. (4 marks)

(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 Cala Ltd is developing a new product which can be fitted to domestic heating systems to reduce fuel consumption. You are a member of a project team with responsibility for the development of the product, which has been given the working title of 'Heatsave'. A market research report indicates that sales volume will be dependent on the selling price at which the product is initially launched. The market research report provided the following data:

Initial Selling Price	Sales Volume (units x 1,000)				
£	2006	2007	2008	2009	2010
200	46	52	55	57	49
225	42	45	49	50	46
230	35	38	41	44	34

Initial product costings have been prepared, based on the proposed specification. These indicate a variable cost per unit of £160, which is made up as follows:

	£
Materials	87
Labour	45
Overheads	28

Fixed production overheads are forecast to be £1·1 million per annum. In addition development costs of £4·7 million have been incurred to date, while further development expenditure of £1·7 million is planned.

The following decision criteria are applied to all new products:
- a target cost pricing approach is to be used
- development costs are capitalised and amortised over the first five years of a product's life cycle
- products are assessed over a five year time horizon
- products must deliver a profit margin of 15% of sales

The managing director has questioned whether it is appropriate to maintain the same selling price throughout the product's life cycle. She has asked you to consider alternative pricing strategies.

Required:

Draft a report to the managing director which:

(a) briefly explains the concept of target cost pricing and how it differs from cost plus pricing; (5 marks)

(b) based on the market research report, indicates the selling price at which the product should be launched, and the reduction in costs which must be achieved if the decision criteria are to be met; (5 marks)

(c) identifies techniques which may be applied to reduce the cost of the product to the required level; and (5 marks)

(d) identifies, and briefly explains, two alternative pricing strategies that could be used. (5 marks)

(20 marks)

5 You are the Product Development Manager for Sarun Ltd. The company produces a range of products and you have been asked to consider the following situations, and brief the management team on the appropriate action.

(a) Sarun's product range includes three products, each of which requires the use of a specialised machine. The machine was bought 14 months ago at a cost of £457,200 and has a useful life of 10,000 machine hours. The cost of the machine is charged to production on the basis of the number of machine hours used. To date 2,200 machine hours have been used.

When the machine was bought, six employees were provided with specialised training, making them the only staff qualified to operate the machine. The training cost a total of £12,500 and this is being charged to production on a straight line basis over five years.

As a result of their specialised training, the staff are paid a premium of £3·70 per labour hour which brings the total machining labour cost to £27·50 per hour.

In the forthcoming 13 week period to 31 October 2005, 2,989 machining labour hours are available. Budgeted data for the period to 31 October 2005 is shown below:

Product	Xon	SuperXon	MegaXon
Selling price (£ per unit)	360·00	450·00	550·00
Variable costs (£ per unit)			
Materials	111·40	114·50	116·30
Labour: machining	82·50	123·75	151·25
assembly	13·10	14·70	15·40
Variable overheads*	33·60	50·40	61·60
Fixed costs*	42·00	63·00	77·00
Demand (units)	450	340	280
Machine hours per unit	0·50	0·75	1·00

* NB The amounts for variable overheads and fixed costs do not include the cost of the machine or the associated training.

Required:

Calculate the volume of each product which should be manufactured in the period to 31 October 2005 to maximise Sarun's profit. (14 marks)

(b) Sarun's purchasing department has identified a company which produces a component that eliminates the need for the specialised machining. If Sarun decides to purchase the component, the specialised machine will be scrapped and the machining staff will be offered voluntary redundancy. The production manager expects two of the staff to accept this offer.

The company accountant has calculated that using the component will reduce the unit cost of each product.

Required:

Explain what other factors Sarun should take into account before deciding whether or not to purchase the component. (6 marks)

(20 marks)

6 Niman Ltd manufactures a range of 120 diversified products. You have recently been appointed as the company's Operations Manager. The company's recent performance has been disappointing, and your appointment is part of a programme to improve results. You have noted that the company does not have a structured approach to managing the supply chain. In addition, you feel that the company would benefit from outsourcing some activities.

You have agreed to brief the management team on these initiatives.

Required:

Prepare briefing notes which:

(a) explain the concept of supply chain management; (4 marks)

(b) identify, and briefly explain, the key elements of supply chain management which must be controlled if the initiative is to be successful; (4 marks)

(c) outline how implementing supply chain management can improve performance; and (4 marks)

(d) explain the benefits and the potential drawbacks which may result from outsourcing. (8 marks)

(20 marks)

End of Question Paper