

Diploma in Financial Management

PAPER DA1, INCORPORATING SUBJECT AREAS

- INTERPRETATION OF FINANCIAL STATEMENTS
- PERFORMANCE MANAGEMENT

MONDAY 5 JUNE 2006

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 THREE questions in total to be answered.

and Candidates MUST answer ONE question from

Section C 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

The Association of Chartered Certified Accountants

Module A



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 of the following is a specific responsibility of the Financial Reporting Council?

- A To issue financial reporting standards
- B To issue international financial reporting standards
- C To oversee the work of the Urgent Issues Task Force
- D To review possible departures from GAAP

2 Which of the following statements about historical cost accounting is correct?

- A Historical cost accounting always overstates the value of assets
- B Historical cost accounting values assets on a more objective basis than current value accounting
- C Historical cost accounting avoids any overstatement of profits
- D Historical cost accounting reports the gains arising from holding assets

3 In the last financial year Cuchabee Ltd issued an invoice for £28,900 for the sale of a fixed asset with a net book value of £27,600.

What was the effect of this transaction on the company's assets, liabilities and capital and reserves?

	Assets	Liabilities	Capital and reserves
A	unchanged	reduced	increased
B	increased	unchanged	increased
C	increased	reduced	increased
D	reduced	unchanged	reduced

4 Consider the following statements:

- (i) both realised and recognised gains are reported in the profit and loss account
- (ii) both realised and recognised gains are reflected in the balance sheet
- (iii) only realised gains are reported in the profit and loss account

Which of the following combinations is correct?

- A (i), (ii) and (iii) are correct
- B only (i) and (ii) are correct
- C only (ii) and (iii) are correct
- D only (iii) is correct

5 In the year to 31 May 2006, Fornest plc acquired 75% of the share capital of Shuque Ltd for £360,000. At the date of the acquisition, Shuque had 500,000 shares of 50p each in issue and retained profits of £150,000.

What is the value of goodwill arising on the acquisition?

- A £40,000
- B £60,000
- C £127,500
- D £290,000

- 6 At 30 April 2006, the net book value of the fixed assets of Bahno Ltd was £80,000 greater than the tax written down value, and the balance brought forward on the deferred tax account was £24,800. The company accountant calculated that the corporation tax charge on the reported profit for the year to 30 April 2006 would be £53,960, based on the tax rate of 24%.

What is the total charge for taxation in the profit and loss account for the year to 30 April 2006?

- A £48,360
- B £59,560
- C £73,160
- D £78,760

- 7 The draft profit and loss account of Pabell Ltd reported an operating profit of £167,549. A loss of £22,400 on the sale of a fixed asset has been included in administrative expenses. During the year the company had sold its retail division to concentrate on manufacturing. This sale had realised a loss of £39,500, which had been reported as an exceptional item.

What is the correct operating profit?

- A £128,049
- B £150,449
- C £167,549
- D £189,949

- 8 Brouha Ltd is a manufacturer of animal feed. The company accountant is preparing the 2006 financial statements, and is considering the impact of a claim for damages of £50,000 which the company received during the year. The company has admitted that it is liable for the damage, and offered the claimant £25,000 to settle the claim. This offer has not been accepted, and the claim will be settled in court. The company's legal advisors have noted that a similar claim was recently settled in court for £35,000.

How should the claim be reported in the 2006 financial statements?

- A as a contingent liability, as the amount is uncertain
- B as a provision of £25,000
- C as a provision of £35,000
- D as a provision of £50,000

- 9 At 30 April 2006 Bigbuild plc had a number of partly completed contracts. Data relating to one of these is shown below:

Total cost to date	£759,000
Cost to complete the contract	£128,000
Cost recognised in cost of sales	£640,000
Contract value	£950,000

At what stock value should the contract be reported on the balance sheet?

- A £119,000
- B £640,000
- C £759,000
- D £950,000

- 10 At 30 April 2005, Fixtures Ltd had provided for a revaluation gain of £30,000 in respect of one of the properties owned and used by the company. In the year to 30 April 2006, the value of another property owned by the company fell by £45,000, due to the announcement of a plan to build a new road. The second property had not previously been revalued.

How are the profit and loss account for the year to 30 April 2006 and the revaluation reserve at that date affected?

	Profit and Loss	Revaluation Reserve
A	not affected	not affected
B	not affected	reduced by £45,000
C	charge of £15,000	reduced to nil
D	charge of £45,000	not affected

- 11 The production manager of Costers Ltd is planning to expand the company's production capacity, and has suggested that as a result of this:
- (i) total expenditure on fixed costs will remain constant
 - (ii) within certain limits, as production volume rises, the fixed cost per unit falls

Which of the statements is/are correct?

- A (i) only
 - B (ii) only
 - C both (i) and (ii)
 - D neither (i) nor (ii)
- 12 Jim Bowe has been trading for the last six months as a fast food retailer. His average gross profit margin for that period was 33%, on sales of £120,000. His total expenses were £25,800. He is considering employing an extra member of staff as he anticipates an increase in business. The cost of the new employee will be £18,000 per annum. To stimulate sales, Jim will also reduce his gross profit margin to 30%.

What percentage increase in sales is needed for Jim to earn the same net profit in the next six months as he earned in the first six months?

- A 21.66%
- B 25.00%
- C 35.00%
- D 60.00%

- 13 Desoft plc is a divisionalised company which develops computer software to clients' specifications. The company has taken a decision to implement a planning and control system based on the 'beyond budgeting' principles.

Which of the following is the company least likely to achieve?

- A cost reduction
- B coordination
- C faster decision making
- D improved motivation

- 14 A local authority has introduced an initiative which is intended to 'achieve greater output for each unit of input'.

What is the objective of the initiative?

- A quality improvement
- B efficiency
- C effectiveness
- D economy

- 15 Consider the following statements about outsourcing:
- (i) only functions which are part of the core business should be outsourced
 - (ii) outsourcing a function transfers total responsibility for meeting quality standards to the external provider

Which of the statements is/are correct?

- A (i) only
 - B (ii) only
 - C both (i) and (ii)
 - D neither (i) nor (ii)
- 16 In the four week production period just completed, Browndawff Ltd produced 570 units. The standard labour cost for each unit was £13·50, based on budgeted production of 550 units. The actual labour cost for the period was £8,238.

What was the labour rate variance for the period?

- A £543 adverse
 - B £543 favourable
 - C £813 adverse
 - D £813 favourable
- 17 The directors of Criddle plc are considering the potential benefits that may be expected from the introduction of supply chain management. They have been discussing the impact on costs and speed of response to customer orders.

What is the likely impact of supply chain management on costs and speed of response?

Supplier costs are likely to be: Speed of response is likely to be:

- | | |
|-------------|------------|
| A reduced | improved |
| B increased | improved |
| C reduced | unaffected |
| D increased | unaffected |
- 18 In the year 30 April 2006 Goway Ltd acquired, under an operating lease, the use of a machine which would have cost £340,000 to purchase outright. The lease rentals during the year were £120,000. The company's operating profit for the year was £2,854,800. At the year end the balance sheet reported a net assets value of £11,600,000. The directors estimate that there is no significant difference between the book value and economic value of the net assets. The company's cost of capital is estimated to be 14%.

What is Goway's Economic Value Added (EVA®) for the year to 30 April 2006?

- A £1,183,200
 - B £1,230,800
 - C £1,303,200
 - D £1,350,800
- 19 Meadow Ltd operates an activity based costing system. The budgeted costs for warehousing for the next six months are £356,014, of which £215,414 is in respect of handling receipts of materials. The balance is for the issue of goods to production. In the same period, it is expected that 3,700 orders will be received and 2,500 issues will be made. The company has received an order which will generate 14 receipts and 6 issues.

What is the warehousing cost to be included in the total cost of the order?

- A £337·44
- B £815·08
- C £1,148·43
- D £1,152·52

20 Which of the following statements is correct?

- A** Target costing and kaizen costing are both used in the development of new products
- B** Kaizen costing is used in new product development, and target costing is used once production has commenced
- C** Target costing and kaizen costing are both used to manage product costs during the production process
- D** Target costing is used in new product development, and kaizen costing is used once production has commenced

(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 While the primary purpose of financial statements is to report to shareholders, it is a fundamental principle that they should also be useful to a wide range of users. The Accounting Standards Board (ASB) has laid down guidelines for ensuring that this objective is achieved in the Statement of Principles. In that document, the qualitative characteristics of useful financial information are identified as: relevance, reliability, comparability and understandability.

Required:

- (a) **Other than shareholders, identify two groups which will have an interest in the financial statements of an entity, and compare and contrast the needs of such users with the needs of shareholders.** (6 marks)
- (b) **Explain the four qualitative characteristics of useful financial information identified in the statement of principles, and indicate how each of these contributes to meeting the needs of one of the users you have identified in (a).** (14 marks)

(20 marks)

- 2 You are the research and development director of Kwergeg Ltd. At the next board meeting, decisions will be made on the accounting treatment of two projects that your team began working on in the current financial year. You have been asked to provide the information the board will require to make the relevant decisions.

Details of the two projects are:

Yerman Project

This project is being conducted in partnership with a local university. The aim is to produce an improved specification for an industrial detergent which will allow waste water to be used in industrial processes. Early indications suggest that the product will be commercially viable, and it is planned to set up a separate division to manufacture and market the product. Production is likely to commence in 2009, with sales commencing in 2010. The product is expected to have a life span of eight years. Expenditure to date on this project is £2.45 million.

Soawill Project

A previous project had indicated a potential link between soil nutrients and the speed of biodegradation of waste materials. If this link can be proved, there is a possibility that by manufacturing additives, landfill sites may become re-useable after a period of time. The technical director has reported that, based on the evidence currently available, she believes the link will be proved and that it will be possible to obtain a specification for a marketable product. To date £3.2 million has been spent on the project, but no definitive costings for the product have been prepared, and the size of the potential market has not been investigated. It is anticipated that any product which is an outcome of the research will have a life span of at least 15 years.

Required:

In preparation for the board meeting prepare a briefing paper which:

- (a) **Differentiates between research costs and development costs.** (6 marks)
- (b) **Explains the accounting treatment which should be applied to each of these categories of cost.** (8 marks)
- (c) **Calculates the effect of the two projects on Kwergeg's financial statements.** (6 marks)

(20 marks)

- 3 You are a self employed business consultant, providing general business and financial advice to individuals. One of your clients has been asked to consider investing in Almon Ltd, a private company owned by one of his friends. Your client is particularly interested in the ability of Almon Ltd to generate cash.

Almon Ltd's draft financial statements have been prepared and you have extracted the following information:

Information from Profit and Loss Account for year to 31 May 2006:

Depreciation charge	127,480
(NB there were no disposals of fixed assets in the year)	
Tax charge	45,600
Interest charge	17,800

Balance Sheet at 31 May	2006		2005	
	£	£	£	£
<i>Fixed assets</i>		1,540,720		1,486,200
<i>Current assets</i>				
Stock	162,832		180,560	
Debtors	241,580		195,890	
Cash at bank	158,964	563,376	–	376,450
<i>Creditors: amounts falling due within one year</i>				
Creditors	136,907		128,569	
Interest	7,420		6,800	
Tax	28,650		23,400	
Loans	30,000		19,000	
Bank overdraft	–	202,977	53,082	230,851
<i>Net current assets</i>		360,399		145,599
<i>Creditors: Amounts falling due in more than one year:</i>				
Long term loans		270,000		141,000
		1,631,119		1,490,799
<i>Financed by:</i>				
Ordinary shares of £5 each		1,200,000		1,200,000
Profit and loss account		431,119		290,799
		1,631,119		1,490,799

Required:

- (a) Prepare the Cash Flow Statement for Almon Ltd for the year to 31 May 2006. (14 marks)
- (b) Highlight the major issues revealed by the cash flow statement and briefly suggest the further information your client should obtain before deciding whether or not to invest in Almon Ltd. (6 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 Travelmate Ltd produce travel guides for a variety of major cities worldwide. The company is about to commission a new guide for Beijing. You are the company’s production director and the managing director has asked you to use the expected value criterion to decide whether the guide should focus on the 2008 Olympics or whether it should be a general guide to the city. Market research has indicated that a focus on the Olympics is likely to increase sales of the guide in the short term, but that no guides will be sold after the event has taken place. The sales projections, and the associated probabilities for the Olympics guide are:

Sales volume (000s)	Probability
30	0.25
50	0.44
60	0.31

The guides will be sold for £5 each, and the printing costs are estimated to be £1.75 per copy, plus a set up cost of £33,500. The company has already signed a contract for the supply of photographs to be included in the guide at a cost of £19,000. The Olympics guide will also include a number of drawings and narrative items. No contract has been signed for these, but the total cost is estimated at £14,600.

If the company decides to publish a general guide, all of the photographs which will be needed can be taken from the Olympics guide. However, as there will be fewer photographs, a different photographer has quoted a cost of £8,000 for providing the general guide photographs. The drawings and narrative in the general guide will be reduced, and the cost of these guides will be £9,300. The general guides will sell for £4 each and printing costs will be the same as for the Olympics guide. The print run will be 50,000 copies. The market research indicates that the full print run will be sold.

Required:

- (a) Using the expected value criterion, calculate whether the Olympics guide or the general guide should be produced. (11 marks)
- (b) Draft a memo to the managing director which:
- (i) explains the relevance of the photography costs and the drawings and narrative costs for the decision; and (4 marks)
 - (ii) outline the limitations of the expected value decision criterion in this example. (5 marks)

(20 marks)

- 5** You are the operations manager of Dedawn Ltd, a manufacturing company. The company's overdraft has recently been increasing, and the directors are concerned that the current overdraft limit of £50,000 may not be sufficient. You have been asked to prepare budgets for the next six production periods, based on the following data:
- 1 Sales demand for the next seven four weekly production periods (in units) are:
P1 – 400 P2 – 280 P3 – 410 P4 – 420 P5 – 400 P6 – 310 P7 – 430
The selling price of each unit is £1,200
 - 2 As a precaution against stock-outs, the company maintains a buffer stock of finished goods. At the end of each period this is equivalent to 10% of the sales target for the next period.
 - 3 The materials supplier is able to fulfil orders immediately, and no stock of materials is held.
 - 4 Materials purchases are subject to one month's credit.
 - 5 Each unit produced requires 30 kg of materials at a cost of £28 per kg.
 - 6 Due to the nature of the production process, the production team is maintained at a constant level of 30 staff. The team can produce 95 units each week.
 - 7 If the required level of production falls below the volume which this team can produce, production is temporarily suspended. In this situation the staff are paid at normal rates. If production requirements rise above the level which the team can produce in a normal week, the additional production can be achieved through overtime.
 - 8 The production staff are paid at a flat rate of £380 per week each. If overtime is required, a premium of 60% of the labour cost is paid for each additional unit produced.
 - 9 Employment related costs are 10% of wages.
 - 10 The production process is closed for holidays for one week in period 2 and one week in period 6. Staff will continue to be paid during these holiday periods.
 - 11 Sales are made on the basis of one month's credit, but 20% of customers do not pay until the second month following sale.
 - 12 All other costs are fixed at £25,000 per week and are paid as incurred.
 - 13 The company's accountant has estimated that at the beginning of the budget period:
 - (i) the bank account will be overdrawn by £34,700;
 - (ii) £293,510 will be owed to the materials supplier; and
 - (iii) £556,000 will be owed by customers, of which £460,000 will be received in P1, with the balance being received in P2.

Required:

Prepare the following budgets for each of the six periods:

- | | |
|--|------------|
| (a) production volume (in units); | (2 marks) |
| (b) materials usage (in kg); | (1 mark) |
| (c) materials purchases (in £); | (1 mark) |
| (d) cash (in £, using the format shown on page 11); | (11 marks) |
| (e) comment on the main issues which are revealed by the cash budget. | (5 marks) |

The information below relates to question 5(d) opposite.

Format for Cash Budget		P1	P2	P3	P4	P5	P6
		£	£	£	£	£	£
Inflow:	Debtors						
Outflow:	Suppliers						
	Wages						
	Employment costs						
	Other costs						
	Total outflow						
Net cash flow							
Opening balance							
Closing balance							

(20 marks)

- 6 You have recently been appointed to the post of business development manager in Quris Ltd. The company has been a manufacturer of components used in the electronics industry for over 25 years. The product range is based on a number of different standard designs, but customers frequently request minor changes to the standard designs to facilitate their specific requirements.

The company is organised as a traditional hierarchy, and product quality is managed on the basis of statistical control.

The company has a good reputation for quality and customer service, but in recent years has been struggling to match the levels of quality and service achieved by its competitors on a regular basis.

One of your key tasks in the immediate future is to achieve the changes which will be necessary to improve the company's competitive position.

One of the directors of Quris has suggested that the company should consider introducing just-in-time (JIT), and you have been asked to advise the board on the implications of this suggestion.

Required:

- (a) **Outline the key elements of the just-in-time philosophy and differentiate between just-in-time purchasing and just-in-time production.** (8 marks)
- (b) **Discuss how the culture of the company is likely to change as a result of introducing JIT.** (6 marks)
- (c) **Indicate three problems which are likely to arise if the company introduces JIT, and suggest how these may be overcome.** (6 marks)

(20 marks)

End of Question Paper