Chartered Secretaries Qualifying Scheme – Level One

Financial Reporting and Analysis

June 2011

Tuesday morning 7 June 2011

Time allowed: 3 hours and 15 minutes
(including reading time)

Do not open this examination paper until the presiding officer or an invigilator tells you to.

You must not take this paper out of the examination room.

This examination paper is divided into **two** sections. Each question on this paper is worth 25 marks. **You must answer** the **compulsory** question in Section A.

Section B contains **five** questions. You must attempt **three questions only** from Section B.

Section A

*Compulsory – **you must answer** this question.*

1. The following information has been extracted from the draft financial statements of Tidworth Ltd. ('Tidworth'), which is a manufacturing company. IFRS balance sheet format is used below. The company transitioned to IFRS as of its 31 March 2011 year-end.

Income Statement for the year ended 31 March	**2012**	**2011**
	$000	**$000**
Revenue	135,000	90,000
Operating profit	8,440	4,500
Finance costs	2,230	-
Profit before tax	6,210	4,500
Taxation expense	2,070	1,540
Profit after tax	4,140	2,960

Statement of Financial Position at 31 March	**2012**	**2011**
	$000	**$000**
Assets		
Property, plant and equipment at cost	60,000	40,000
Accumulated depreciation	22,000	16,000
	38,000	24,000
Current assets		
Inventories	8,800	6,000
Trade receivables	23,260	12,000
Cash and cash equivalents	-	700
	32,060	18,700
Total assets	70,060	42,700
Equity and liabilities		
Share capital	20,000	20,000
Retained earnings	19,590	16,760
Total equity	39,590	36,760
Non-current liabilities		
Long-term borrowings	16,000	-
Current liabilities		
Trade payables	6,540	4,400
Bank overdraft	5,860	-
Taxes payable	2,070	1,540
Total current liabilities	14,470	5,940
Total liabilities	30,470	5,940
Total equity and liabilities	70,060	42,700

The following further information is provided relating to the year to 31 March 2012:

- Plant was purchased on 1 April 2011 at a cost of $20,000,000. The new plant immediately became fully operational.
- Sales increased by 50% from 1 April 2011 as the result of a major advertising campaign undertaken in the spring of 2011.

(continued)

- The loan was raised at 9% interest on 1 April 2011 and is repayable in four equal annual instalments commencing 1 April 2012.

- A dividend of $1,310,000 was paid on 30 June 2011.

The company's bankers have advised the directors of Tidworth that the bank overdraft needs to be repaid by 31 March 2013. The following forecasts have been made:

- Operating profit in the year to 31 March 2013 will remain at the same level as in the year to 31 March 2012 and the amount of depreciation charged will also be the same.

- The levels of inventories, trade receivables and trade payables at 31 March 2013 will be the same as at 31 March 2012.

- The company will need to replace fully depreciated plant at a cost of $2,400,000 in June 2012.

Required

(a) Prepare a cash flow statement for the year to 31 March 2012.

(7 marks)

(b) As company secretary, write a succinct report for the board of Tidworth which:

- Examines the financial progress and position of the company based on the cash flow statement prepared under (a), above, and not more than five relevant ratios focusing on asset utilization and short-term liquidity.

- Assesses whether the company is likely to be able to repay the overdraft by 31 March 2013. You should support your assessment with an estimated cash flow statement for the year to 31 March 2013.

(18 marks)

Note: You may make any reasonable assumptions when preparing the estimated cash flow statement under (b), above.

(Total: 25 marks)

Section B

*Answer **three** questions from this section.*

2. The following trial balance relates to the financial affairs of Onchan Ltd. ('Onchan'), a trading company, as at 31 March 2012. It is a Canadian public company. The company transitioned to IFRS during its year ended 31 March 2011. It is now one year later after the IFRS transition.

	$000	**$000**
Sales revenue		51,500
Administration, selling and distribution expenses	17,500	
Cost of sales	30,270	
Real estate properties	13,500	
Rented office building	13,200	
Investments	5,980	
2,000,000 shares in an associated company at cost	3,600	
Inventories	7,200	
Trade accounts receivables	5,100	
Cash at bank	2,110	
Trade accounts payables		5,380
Ordinary share capital (shares of $1 each)		18,000
Retained profit at 1 April 2011.		23,580
	98,460	98,460

The following additional information is provided:

(i) The real estate properties were revalued at $50,000,000 on 31 March 2012 and the directors have decided to use this figure for the purpose of financial reporting as of 31 March 2012.

(ii) The rented office building is a separate cash generating unit and an impairment review was undertaken on 31 March 2012. This revealed that the office building had a value in use of $11,310,000 while its net selling price was $9,840,000.

(iii) The transactions on the Investment account during the year to 31 March 2012 were as follows:

	$000
Purchase of a 6% debenture issued by a major supplier, Erin Ltd. on 1 April 2011. The directors intend to hold the debenture until maturity. The effective rate of interest receivable over the life of the debenture is 8%.	5,000
Interest received from Erin Ltd. on 31 March 2012.	300
100,000 shares in a listed company, Ramsey Ltd., purchased with cash, which is temporarily surplus to requirements. The shares had a market price of $18.20 per share on 31 March 2012.	1,400
Dividend received from Ramsey Ltd.	120

(continued)

(iv) Alderney Ltd is an associated company with an issued share capital of 5,000,000 ordinary shares of $1 each. The shares in Alderney Ltd. were purchased on 1 April 2011 for the figure appearing in the trial balance. Alderney Ltd. reported a profit of $1,300,000 for the year to 31 March 2012.

(v) Onchan trades in three different products for which the following information is provided at 31 March 2012:

Product	**Cost**	**Net realisable value**
	$000	**$000**
Exe	2,400	3,500
Wye	3,100	1,620
Zed	1,700	2,350

Required

Prepare the Income Statement of Onchan for the year to 31 March 2012 and the Statement of Financial Position at that date, in accordance with the provisions of IAS 1 'Presentation of Financial Statements' as adopted for Canadian financial reporting purposes.

(25 marks)

Notes: All items are material.
Calculations to the nearest $000.
Ignore taxation.

3. The Statements of Financial Position of Castletown Ltd. ('Castletown') and Douglas Ltd. ('Douglas') as at 31 December 2011 contained the following information:

	Castletown	Douglas
Assets	**$ million**	**$ million**
Non-current assets	126	38
Net current assets	79	12
Total assets	205	50
Equity		
Ordinary shares of $1 each	100	20
Retained profit at 1 January 2011	83	25
Profit for 2011	22	5
Total equity	205	50

The following additional information is provided:

(i) Castletown purchased 16 million shares in Douglas on 1 January 2011. The purchase consideration consisted of 12 million shares in Castletown, which were valued at $6.50 each at the acquisition date. This transaction has not yet been entered in the books of Castletown and is not reflected in the above Statement of Financial Position.

(ii) The fair value of Douglas's non-current assets at 1 January 2011 was $48 million. Douglas neither purchased nor sold any non-current assets during 2011. There were no material differences between the carrying value and fair value of Douglas's net current assets at the date of acquisition.

(iii) The directors of Castletown estimated, at the date of acquisition, that costs of $7 million will need to be incurred in 2012 to reorganise the activities of Douglas so as to maximise the benefits arising from the amalgamation of the two companies' activities. The directors are of the opinion that these reorganization costs should be treated as part of the purchase price.

(iv) During 2011, Castletown transferred to Douglas goods which cost $5 million, at their market selling price of $8 million. These goods remained unsold at the year end and are included among inventories in Douglas's Statement of Financial Position.

Required

(a) Define 'fair value' in accordance with IFRS 3 'Business Combinations' as adopted for Canadian financial reporting purposes.

(3 marks)

(b) Advise the management of Castletown concerning the appropriate accounting treatment of (i) non-current asset values at the acquisition date and (ii) the planned future reorganization costs in order to comply with IFRS 3 and any other relevant accounting standard.

(8 marks)

(c) Prepare the consolidated Statement of Financial Position of Castletown and its subsidiary, Douglas, at 31 December 2011 in accordance with standard accounting practice.

(14 marks)

Note: Ignore depreciation and impairment of non-current assets.

(Total: 25 marks)

4. Harborough Ltd. ('Harborough') is a Canadian listed public company on the TSX Exchange, which makes up its accounts on the calendar year basis. The following information is provided relating to its business operations:

(i)

	2011	2010
	$ million	**$ million**
Sales revenue	2,420	2,300
Cost of sales	1,640	1,500
Operating expenses	500	428

(ii) Harborough operates through two divisions: the Newton division trades in the product Newton, and the Lowestoft division trades in the product Lowestoft. The following information is provided in respect of the Newton division for 2011:

	$ million
Sales revenue	600
Cost of sales	520
Operating expenses	142

(iii) Raydon Ltd. ('Raydon') is a competitor of Harborough, trading solely in the product Lowestoft. The following information is provided for Raydon for 2011:

	$ million
Sales revenue	1,680
Operating profit	300
Gross assets	2,040

(iv) You discover that the gross assets attributable to the products traded in by Harborough at 31 December are as follows (there are no common assets unallocated to divisions):

	2011	2010
	$ million	**$ million**
Newton	360	400
Lowestoft	1,920	1,800

Required

(a) Outline the objective of IFRS 8 'Operating Segments' as adopted for Canadian financial reporting purposes.

(3 marks)

(b) Prepare the Income Statement of Harborough for 2011 in accordance with the requirements of IFRS 8, so far as the information permits, so as to reveal the separate results of each business segment.

(6 marks)

(continued)

(c) Write a succinct report for the board which reviews:

(i) The overall performance of Harborough in 2011 compared with the previous year.
(ii) The performance of the Lowestoft business segment of Harborough compared to that of Raydon.

Your report should include:

- Calculations of the following ratios: total asset turnover, operating profit percentage and return on gross assets.
- An explanation of the relationship between the three ratios.
- A consideration of the action the directors of Harborough might wish to take on the basis of your findings.

(16 marks)

(Total: 25 marks)

5. Identify and discuss any four reasons for differences in financial reporting systems between countries.

(25 marks)

6. Discuss the following issues in the context of corporate governance and the external auditor:

(a) The advantages to an audit client of its auditors providing consultancy services it requires, rather than engaging a different firm to do the work.

(12 marks)

(b) The potential problems associated with accounting firms providing consultancy services to their audit clients.

(13 marks)

(Total: 25 marks)