Fundamentals Level – Skills Module

Financial Reporting

September/December 2017 – Sample Questions

Paper F7

Time allowed: 3 hours 15 minutes

This question paper is divided into three sections:

Section A – ALL 15 questions are compulsory and MUST be attempted

Section B – ALL 15 questions are compulsory and MUST be attempted

Section C – BOTH questions are compulsory and MUST be attempted

Do NOT open this question paper until instructed by the supervisor.

Do NOT record any of your answers on the question paper.

This question paper must not be removed from the examination hall.

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Section C – BOTH questions are compulsory and MUST be attempted

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

31 Mowair Co is an international airline which flies to destinations all over the world. Mowair Co experienced strong initial growth but in recent periods the company has been criticised for under-investing in its non-current assets.

Extracts from Mowair Co's financial statements are provided below.

Statements of financial position as at 30 June:

	20X7 $'000	20X6 $'000
Assets		
Non-current assets		
Property, plant and equipment	317,000	174,000
Intangible assets (note ii)	20,000	16,000
	337,000	190,000
Current assets		
Inventories	580	490
Trade and other receivables	6,100	6,300
Cash and cash equivalents	9,300	22,100
Total current assets	15,980	28,890
Total assets	352,980	218,890
Equity and liabilities		
Equity		
Equity shares	3,000	3,000
Retained earnings	44,100	41,800
Revaluation surplus	145,000	Nil
Total equity	192,100	44,800
Liabilities		
Non-current liabilities		
6% loan notes	130,960	150,400
Current liabilities		
Trade and other payables	10,480	4,250
6% loan notes	19,440	19,440
Total current liabilities	29,920	23,690
Total equity and liabilities	352,980	218,890

Other EXTRACTS from Mowair Co's financial statements for the years ended 30 June:

	20X7 $'000	20X6 $'000
Revenue	154,000	159,000
Profit from operations	12,300	18,600
Finance costs	(9,200)	(10,200)
Cash generated from operations	18,480	24,310

The following information is also relevant:

(i) Mowair Co had exactly the same flight schedule in 20X7 as in 20X6, with the overall number of flights and destinations being the same in both years.

(ii) In April 20X7, Mowair Co had to renegotiate its licences with five major airports, which led to an increase in the prices Mowair Co had to pay for the right to operate flights there. The licences with ten more major airports are due to expire in December 20X7, and Mowair Co is currently in negotiation with these airports.

Required:

(a) Calculate the following ratios for the years ended 30 June 20X6 and 20X7:

(i) Operating profit margin;
(ii) Return on capital employed;
(iii) Net asset turnover;
(iv) Current ratio;
(v) Interest cover;
(vi) Gearing (Debt/Equity).

Note: For calculation purposes, all loan notes should be treated as debt. (6 marks)

(b) Comment on the performance and position of Mowair Co for the year ended 30 June 20X7.

Note: Your answer should highlight any issues which Mowair Co should be considering in the near future. (14 marks)

(20 marks)

32 The following are the draft statements of financial position of Party Co and Streamer Co as at 30 September 20X5:

	Party Co $'000	Streamer Co $'000
ASSETS		
Non-current assets		
Property, plant and equipment	392,000	84,000
Investments	120,000	Nil
	512,000	84,000
Current assets	94,700	44,650
Total assets	606,700	128,650
EQUITY AND LIABILITIES		
Equity		
Equity shares	190,000	60,000
Retained earnings	210,000	36,500
Revaluation surplus	41,400	4,000
	441,400	100,500
Non-current liabilities		
Deferred consideration	28,000	Nil
Current liabilities	137,300	28,150
Total equity and liabilities	606,700	128,650

The following information is relevant:

(i) On 1 October 20X4, Party Co acquired 80% of the share capital of Streamer Co. At this date the retained earnings of Streamer Co were $34m and the revaluation surplus stood at $4m. Party Co paid an initial cash amount of $92m and agreed to pay the owners of Streamer Co a further $28m on 1 October 20X6. The accountant has recorded the full amounts of both elements of the consideration in investments. Party Co has a cost of capital of 8%. The appropriate discount rate is 0·857.

(ii) On 1 October 20X4, the fair values of Streamer Co's net assets were equal to their carrying amounts with the exception of some inventory which had cost $3m but had a fair value of $3·6m. On 30 September 20X5, 10% of these goods remained in the inventories of Streamer Co.

(iii) During the year, Party Co sold goods totalling $8m to Streamer Co at a gross profit margin of 25%. At 30 September 20X5, Streamer Co still held $1m of these goods in inventory. Party Co's normal margin (to third party customers) is 45%.

(iv) The Party group uses the fair value method to value the non-controlling interest. At acquisition the non-controlling interest was valued at $15m.

Required:

(a) Prepare the consolidated statement of financial position of the Party group as at 30 September 20X5. (15 marks)

(b) Party Co has a strategy of buying struggling businesses, reversing their decline and then selling them on at a profit within a short period of time. Party Co is hoping to do this with Streamer Co.

As an adviser to a prospective purchaser of Streamer Co, explain any concerns you would raise about making an investment decision based on the information available in the Party Group's consolidated financial statements in comparison to that available in the individual financial statements of Streamer Co. (5 marks)

(20 marks)

End of Question Paper