SIM UNIVERSITY

ACC207
Corporate Accounting and Financial Statement Analysis

Assignment 2 – Group-based Assignment

January 2017 Presentation

Group-based Assignment

This assignment is worth 30% of the final mark for ACC207 Corporate Accounting and Financial Statement Analysis.

The cut-off date for this assignment is **12 April 2017, 2355 hrs**.

This is a group-based assignment. You should form a group of **3 members** from your seminar group. Each group is required to upload a single report to Canvas via your respective seminar group. Please elect a group leader. The responsibility of the group leader is to upload the report on behalf of the group.

It is important for each group member to contribute substantially to the final submitted work. All group members are equally responsible for the entire submitted assignment. If you feel that the work distribution is inequitable to either yourself or your group mates, please highlight this to your instructor as soon as possible. Your instructor will then investigate and decide on any action that needs to be taken. It is not necessary for all group members to be awarded the same mark.

Take note of the following format and writing requirements. Marks will be penalised for failure to follow requirements.

Format requirements:

- A properly formatted cover page: To include course code, course title, assessment title, student name(s), student PI Number(s).
- For text, Font style: Times New Roman; Font size: 12; Line spacing: 1.5 lines.
- Include the page number on each page.
- Reference or bibliography at the end (use APA referencing guidelines).

Writing requirements:

- Develop your points in a clear, logical and succinct manner.
- Be mindful of the target audience/reader. Use language appropriate to the reader's expected level of knowledge.
- Free from grammatical and typographical errors.
- Provide in-text citations when referencing (use APA referencing guidelines).
- Include less relevant details as an appendix if necessary.
- Good overall presentation of the report.

Question 1

Tang's summarized financial statements for the years ended 31 March 20x2 and the comparative figures are shown below.

Statements of comprehensive income
for the year ended 31 March

	20x2	20x1
	$ m	$ m
Revenue	2,700	1,820
Cost of sales	(1,890)	(1,092)
Gross profit	810	728
Distribution costs	(230)	(130)
Administrative costs	(345)	(200)
Finance costs	(40)	(5)
Profit before tax	195	393
Income tax expense	(60)	(113)
Profit for the year	135	280
Other comprehensive income	80	Nil
Total comprehensive income	215	280

Statements of financial position
as at 31 March

	20x2		20x1	
	$ m	$ m	$ m	$ m
Assets				
Non-current assets:				
Property, plant and equipment		680		410
Intangible asset: manufacturing licence		300		200
Investment at cost: shares in Raremetal		230		-
		1,210		610
Current assets:				
Inventory	200		110	
Trade receivables	195		75	
Bank	-	395	120	305
Total assets		1,605		915
Equity and liabilities				
Equity:				
Equity shares (20x2: 350 million shares; 20x1: 250 million shares)		350		250
Reserves				
Revaluation		80		-
Retained earnings		375		295

		805		545
Non-current liabilities:				
5% loan notes	100		100	
10% secured loan notes	300	400	-	100
Current liabilities:				
Bank overdraft	110		-	
Trade payables	210		160	
Current tax payable	80	400	110	270
Total equity and liabilities		1,605		915

Statement of cash flows
for the year ended 31 March 20x2

Cash flows from operating activities:	**$ m**	**$ m**
Profit before tax		195
Adjustments for:		
Depreciation/amortisation of non-current assets		140
Finance costs		40
Increase in inventory		(90)
Increase in trade receivables		(120)
Increase in trade payables		50
Cash generated from operations		215
Interest paid		(40)
Income tax paid		(90)
Net cash from operating activities		85
Cash flows from investing activities:		
Purchase of property, plant and equipment	(305)	
Purchase of intangibles	(125)	
Purchase of investment	(230)	
Net cash used in investing activities		(660)
Cash flows from financing activities:		
Shares issued	100	
Issue of 10% loan notes	300	
Equity dividends paid	(55)	
Net cash from financing activities		345
Net decrease in cash and cash equivalents		(230)
Cash and cash equivalents at beginning of period		120
Cash and cash equivalents at end of period		(110)

The following information is relevant:

Depreciation/amortization charges for the year ended 31 March 20x2 were:

	$ million
Property, plant and equipment	115
Intangible asset: manufacturing licence	25

There were no sales of non-current assets during the year, although the property has been revalued.

The following additional information has been obtained in relation to the operations of Tang plc for the year ended 31 March 20x2:

(i) On 1 June 20x1, Tang won a tender for a new contract to supply Jetside with aircraft engines that Tang plc manufactures under a recently-acquired licence. The bidding process was very competitive and Tang plc had to increase its manufacturing capacity to fulfil the contract.

(ii) Tang also decided to invest in Raremetal by acquiring 8% of its equity shares in order to secure supplies of specialised materials used in the manufacture of the engines. No dividends were received from Raremetal nor had the value of its shares changed since acquisition.

(iii) Tang revalued its property during the year to facilitate the issue of the 10% loan notes.

On seeing the results for the first time, one of the company's non-executive directors is disappointed by the current year's performance.

Required:

(a) Explain how the new contract and its related costs may have affected Tang's operating performance, identifying any further information that may be useful to your answer.

Your answer should be supported by calculating appropriate ratios in profitability, solvency and fixed asset turnover but ratios and analysis of working capital are not required.

(65 marks)

(b) Do an analysis on the cash flow statement and give your recommendation on what should have been done to prevent the deterioration of cash and cash equivalents from the previous year.

(10 marks)

Question 2

(a) Define the term "quality of earnings". Is it a desirable trait?

(3 marks)

(b) Discuss the ***four (4)*** techniques that management can use to improve a company's reported earnings performance in the short run.

(8 marks)

(c) Give ***four (4)*** examples of low-quality earnings components.

(4 marks)

Question 3

(a) What are "free cash flow"? Explain the difference between a company operating cash flow and its free cash flow.

(4 marks)

(b) Reported earnings numbers often contain ***three (3)*** distinctly different components, each subject to a different earnings capitalization rate:

(i) A permanent earnings component, which is expected to persist into the future and is therefore valuation-relevant. In theory, the multiple for this component should approach 1/r.

(ii) A transitory earnings component, which is valuation-relevant but is not expected to persist into the future. Because transitory earnings result from one-time events or transactions, the multiple for this component should approach 1.0.

(iii) A value-irrelevant earnings (or noise) component, which is unrelated to *future free cash flow* or future earnings and therefore, is not pertinent to assessing current share price. Such earnings components should carry a multiple of zero.

Above statements are extracted from the title, Financial reporting & Analysis by Revsine, Collins, Johnson, Mittelstaedt: "Research on Earnings and Equity valuation".

Required:

Name the elements of the multiple-step income statements that correspond to the three earnings components listed under (i) to (iii) above. Briefly explain your selection.

(6 marks)

---- END OF ASSIGNMENT ----