



Objective Based Assessment

CB1 Specimen Examination

Core Business - Finance

This specimen examination aligns to the 2023 syllabus and core reading and is a representation of the depth and breadth that will be covered in a single examination.

There are 65 questions in total.

Answers can be viewed in the bottom right corner of each page. Use the drop-down menu to reveal the correct answer.

If you are practicing under exam-conditions, you should not exceed 1 hour and 40 minutes.

This PDF specimen examination is not representative of the new exam system, some question formats have therefore been adapted accordingly.

This specimen examination will also be made available in the new exam system in 2023 to allow familiarisation with all question formats prior to September 2023.

Q. 1

Instructions to candidates:

Select **ONE (1)** option.

Question:

Which statement best reflects the purpose of International Financial Reporting Standards (IFRS)?

Options:

- A. Ensuring that taxable profit is calculated accurately.
- B. Teaching accountants about correct accounting treatments.
- C. Encouraging consistency between different companies' accounts.
- D. Driving economic growth through capital market efficiency.

Q. 2

Instructions to candidates:

Select from the drop-down menus to complete the sentences.

Question:

Jess is currently Company F's Finance Director.

Jess plans to retire, but the Board wishes Jess to remain with Company F as a non-executive director.

In the event of such an appointment Jess will not be an independent non-executive director as she would have previously served on Company F's Board.

If Jess accepts this role, it would be _____ for her to work closely with the replacement Finance Director.

Jess _____ require training in her new role, given the nature of her past employment with Company F.

Company F's external auditor will be _____ if Jess remains on the Board as a non-executive.

Q. 3

Instructions to candidates:

Match each descriptor to its corresponding option by drawing a line between them.

Each option can only be used once.

Question:

Company K's remuneration committee plans to change the way in which the company's executive directors are remunerated.

Match each of the four remuneration bases to its associated shortcoming.

Remuneration base		Shortcoming	
A.	Fixed salary	(i)	The directors could take a short-term view when making decisions.
B.	Profit related bonus scheme	(ii)	The shareholders might be concerned that remuneration is excessive.
C.	Equity-based remuneration scheme	(iii)	The shareholders might not trust the directors to work in their interests.
D.	Rewards based an annual appraisal by Remuneration Committee	(iv)	Benefits might be affected by events that are outside the directors' control.

Q. 4

Instructions to candidates:

Select **TWO (2)** options.

Question:

Which **two** statements explain why quoted companies should have equal numbers of executive and non-executive directors?

Options:

- A. Executives and non-executives will have equal votes at meetings.
- B. Equal numbers will help ensure there are sufficient non-executives to staff board committees.
- C. Equal numbers will ensure that there is diversity on the board.
- D. Ideally, each executive director should be assigned a non-executive.
- E. Non-executives can be mutually supportive in any board discussions.

Q. 5

Instructions to candidates:

Select **TWO (2)** options.

Question:

Company U is a chemical manufacturer with its Head Office in Northland.

Company U's factories are located overseas in host countries that offer access to raw materials and low employment costs.

Company U has a comprehensive risk management system in place.

Which **two** statements are correct?

Options:

- A. U's Board can be blamed for accidents in its factories by host governments.
- B. U's directors can only be held responsible for factory safety if they are chemists.
- C. U's Board should close all factories that manufacture hazardous chemicals.
- D. U's Board can delegate oversight of specific safety risks to designated managers.
- E. U's Board should rely on host governments to check safety in factories.

Q. 6

Instructions to candidates:

Select **ONE (1)** option.

Question:

A company is considering the introduction of a major new product.

Based upon a marketing trial, it expects it to be extremely popular.

The company does not have sufficient financial resources to launch the product and needs to raise funds.

Which statement is correct?

Options:

- A. The project should be rejected because the company has insufficient funds.
- B. The marketing trial is irrelevant to the decision concerning the launch of the product.
- C. The Marketing Department should be heavily involved in estimating the net present value.
- D. The Chief Financial Officer should decide whether to proceed with this product.

Q. 7

Instructions to candidates:

Match each descriptor to its corresponding option by drawing a line between them.

Each option can only be used once.

Question:

Company C is heavily geared with loans secured on valuable land and buildings.

The company is facing severe cash flow problems because of the need to service its borrowings.

Company C's Board believes that the company can only survive for a year unless remedial action is taken.

The Board is considering four courses of action. Match the proposed course of action to a likely outcome.

Action		Outcome	
A.	Enter into a high risk, but potentially profitable, investment.	(i)	This is likely to be rejected.
B.	Seek support from the lenders.	(ii)	The lenders will object and may take legal action.
C.	Announce a large dividend payment using C's remaining cash.	(iii)	Only the shareholders will benefit from the upside.
D.	Undertake a large rights issue.	(iv)	This could benefit both shareholders and lenders.

Q. 8

Instructions to candidates:

Select **ONE (1)** option.

Question:

Which statement relating to the shareholders of an unquoted company is correct?

Options:

- A. The shareholders cannot liquidate their investment in equity.
- B. The shareholders' return cannot be measured accurately.
- C. The shareholders cannot take advantage of a takeover offer.
- D. The shareholders' opinions cannot be made clear to the directors.

Q.9

Instructions to candidates:

Select from the drop-down menus to complete the sentences.

Question:

Company A is a public limited company and considers Environmental, Social and Governance (ESG) issues to be important.

Company A's Board has communicated the following restriction in its publicly available investment mandate:

Company A will not invest in any projects which generate more than 20% of their revenues from tobacco.

These projects are under consideration:

	Revenue from tobacco (% of total revenue)	Revenue from fossil fuels (% of total revenue)	Revenue from other sources (% of total revenues)	Net Present Value (£m)
Project 1	25	10	65	220
Project 2	0	0	100	100
Project 3	10	20	70	110
Project 4	5	5	95	105

A junior member of Company A's marketing team has expressed their personal ethical concerns about investing in projects generating revenue from fossil fuels and believes the company should avoid investing in any such projects.

Based on this information, the most appropriate project for Company A would be Project

If the most appropriate project was unavailable, the second most appropriate project for Company A would be Project

Q.10

Instructions to candidates:

Select **ONE (1)** option.

Question:

P is a qualified actuary, employed by an actuarial consulting firm.

P's immediate superior, who is also a qualified actuary, has asked P to understate the valuation of a client's estimated pension liability.

The client wants that valuation to be understated.

Which statement is correct from an ethical point of view?

Options:

- A. P should understate the liability to comply with the client's wishes.
- B. P should understate the liability as instructed by the superior.
- C. P should seek advice from a senior manager at the consulting firm.
- D. P should accept personal responsibility for the accuracy of the valuation.

Q.11

Instructions to candidates:

Select **TWO (2)** options.

Question:

Alex is the investment manager of Company P's pension fund, which all employees are required to join.

Ely has just joined Company P as a junior manager.

Ely plans to remain with the company for 40 years before retiring on a full pension.

Ely has strong moral objections to financing the activities of the oil industry.

Ely has emailed Alex, asking for details of the fund's existing holding in oil companies and for an assurance that the pension fund will not make further investments in oil companies.

Which **two** statements are correct from an ethical point of view?

Options:

- A. Alex should carry out Ely's request not to invest further fund assets in oil shares.
- B. Alex should retain the fund's existing oil holdings until it would be beneficial to sell.
- C. Alex should refuse Ely's request for information about oil holdings.
- D. Ely should resign if Alex refuses Ely's requests concerning oil investments.
- E. Ely should withdraw the email on the grounds that Company P has many employees.

Q.12

Instructions to candidates:

Select **ONE (1)** option.

Question:

Tom is a junior data analyst at a leading pharmaceutical company.

He has been reviewing the results of a trial for a new drug and believes that they have overstated its effectiveness, which may result in patients not receiving the best treatment.

Tom has reported the matter to his line manager but the company has proceeded to launch the product anyway.

Which action is ethically correct?

Options:

- A. Keep quiet in order to preserve his job since he is relatively junior.
- B. Escalate the matter internally using his company's whistleblowing process.
- C. Escalate the matter by going public and discussing the matter with the media.
- D. Resign without giving a reason and then keep quiet afterwards.

Q.13

Instructions to candidates:

Select **ONE (1)** option.

Question:

Three individuals are considering starting a new business. They have the following considerations:

- They want to protect themselves from personal liability to pay any debts owed in the event of the business becoming bankrupt.
- Initially, they intend to raise £200 million from a combination of debt and equity financing.
- They expect at least 40% of the funding to come from equity raised through a Stock Exchange.

Select the most appropriate capital structure for the business.

Options:

- A. Limited Liability Partnership
- B. Private Limited Company
- C. Sole Trader
- D. Public Limited Company

Q.14

Instructions to candidates:

Select **ONE (1)** option.

Question:

Which statement explains why preference shares are generally treated as debt when interpreting a company's financial statements?

Options:

- A. Preference shareholders have the same rights as lenders.
- B. Preference share capital is an expensive source of funds.
- C. Preference dividends affect equity returns just like interest payments.
- D. Preference shares do not carry voting rights in company meetings.

Q.15

Instructions to candidates:

Select **ONE (1)** option.

Question:

Company F's authorised share capital is 5 million £0.25 shares.

Company F's issued share capital is 2 million shares.

The current market price per share is £0.65.

What is the maximum amount of additional equity capital that Company F can raise?

Options:

- A. £0.75 million
- B. £1.3 million
- C. £1.95 million
- D. £3.25 million

Q.16

Instructions to candidates:

Select from the drop-down menus to complete the sentences.

Question:

The International Accounting Standards Board (IASB) develops new International Financial Reporting Standards (IFRSs) in response to _____ over the most appropriate accounting policy for a particular matter.

The IASB aims to select _____ for that matter.

The IASB's consultation process permits stakeholders to _____ an unpopular proposed IFRS.

Once an IFRS has been finalised, its application becomes _____

Q.17

Instructions to candidates:

Select from the drop-down menus to complete the sentence.

Question:

You have been provided with this information about Person X in respect of a particular tax year:

- received £30,000 from their employment;
- made a capital gain of £15,000;
- bought shares for £20,000, then sold those shares for £22,000.
- No dividends were received in respect of these shares;
- the tax-free allowance was £10,000 for income and £5,000 for capital gains.

Person X will be subject to income tax on _____ and capital gains tax on _____ .

Q.18

Instructions to candidates:

Select from the drop-down menus to complete the sentence.

Question:

RS&T is a large chain of retail outlets selling groceries.

It is privately owned by three shareholders and has an estimated value of \$50 million.

RS&T's Board wishes to invest in a major expansion into the clothing sector.

You have been given this information:

- RS&T's latest financial statement shows an asset gearing of 50%.
- The estimated investment required for the project is \$10 million.
- One of the shareholders wishes to sell their assets in order to fund their retirement.

The most appropriate strategy for RS&T would be to raise finance by
despite the expected .

Q.19

Instructions to candidates:

Select **ONE (1)** option.

Question:

Which statement best describes the characteristics of debenture loans?

Options:

- A. Interest payments depend upon the profitability of borrowers.
- B. The holder's only remedy is to sue the borrower in the event of default.
- C. They are secured on some or all of the borrower's assets.
- D. They are used to raise short-term finance for the borrower.

Q.20

Instructions to candidates:

Select **ONE (1)** option.

Question:

Company U's home currency is the GBP.

It has a large receivable in USD that is due for payment in six (6) months.

Which is the best choice for minimising the risk to the company, associated with movements in the GBP/USD exchange rate?

Options:

- A. Call option.
- B. Put option.
- C. Currency future.
- D. Currency swap.

Q.21

Instructions to candidates:

Calculate, in pence, to 2 decimal places and enter it in the box.

Question:

A company has 100 million shares.

The current market price per share is 100 pence.

The company undertakes a rights issue of one (1) new share for every ten shares currently held.

The issue price is 80 pence per share.

Calculate the theoretical ex-rights price in pence to two decimal places.

 pence

Q.22

Instructions to candidates:

Select **TWO (2)** options.

Question:

Country Y's government has significantly increased its company tax rates.

In response, companies are adapting their behaviour to reduce their tax.

Which **two** actions is Country Y likely to see an increase of?

Options:

- A. More companies raising funds through preferred stock.
- B. More companies raising funds through long-term loans.
- C. More companies attracting foreign investors from countries with low tax rates.
- D. More companies selling and leasing back properties as a form of borrowing.
- E. More companies using retained earnings to fund new projects.

Q.23

Instructions to candidates:

Select **TWO (2)** options.

Question:

W is a wealthy individual who owns 4% of the issued share capital of Company L.

Company L has a large cash balance that has accumulated over the past year.

Company L's Board cannot identify any suitable projects in which to invest that cash.

The Board has approached W and offered to buy back 75% of W's holdings in return for a cash payment.

Which **two** statements explain why W would accept Company L's offer?

Options:

- A. Company L's Board will pay W more than the market value of the shares.
- B. W is concerned that the cash balance might lead to a takeover.
- C. Company L might offer to pay W a scrip dividend instead.
- D. W can use the cash to buy the shares back on the open market.
- E. W's marginal tax rate is lower on capital gains than on dividends.

Q.24

Instructions to candidates:

Select **ONE (1)** option.

Question:

Company D is based in the country of Actuaría.

The table below shows the impact of different capital structures on the total value of Company D's debt + equity:

Debt Allocation (%)	Equity Allocation (%)	D's cost of equity capital	Weighted Average Cost of Capital (%p.a.)	Company Value (Debt + equity) (\$'000)
0	100	6%	6%	450
20	80	6%	4%	500
30	70	8%	7%	400
50	50	9%	9%	360

Consider these statements:

- i. The results in the table contradict Modigliani and Miller's first irrelevance proposition.
- ii. The results in the table are consistent with Modigliani and Miller's second irrelevance proposition.
- iii. Company D's optimal capital structure is 20% debt and 80% equity.

Which of the statements are true?

Options:

- A. (i) and (ii)
- B. (ii) and (iii)
- C. (i) and (iii)
- D. (iii) only

Q.25

Instructions to candidates:

Select from the drop-down menus to complete the sentences.

Question:

X is a fast growing biotechnology company listed on the stock exchange where it is highly rated.

Most of its assets are intangible such as patents.

It has a number of investment opportunities with expected rates of return higher than those generally available to investors.

The Board is considering its dividend policy and decides to _____ most of its profits since it

_____ find it difficult to borrow sufficient funds to finance its investment programme.

Shareholders can be expected to _____ the proposed dividend strategy and any change in

the future may encourage _____ .

Q.26

Instructions to candidates:

Select **THREE (3)** options.

Question:

Which are three correct statements about dividend policy?

Options:

- A. Scrip dividends can be a useful way of changing the capital structure to release cash for companies which have built up a large amount of cash.
- B. Higher dividend payments are more attractive to investors in countries that tax income at a higher rate than capital gains.
- C. Investors are focused on total expected return from investment, regardless of whether it comes in the form of dividend or capital gain.
- D. It would be logical for a young and growing company to have a low level of dividend payments.
- E. A company's directors should announce any planned reduction in dividend payments at the earliest possible opportunity.
- F. Making a high dividend payment may be a way of avoiding a takeover bid for a company with a large amount of cash.

Q.27

Instructions to candidates:

Select **ONE (1)** option.

Question:

Company M is a quoted company that has pursued growth through conglomerate acquisition.

Which best explains why Company M would pursue that growth strategy?

Options:

- A. Shareholders in quoted companies prefer to invest in diversified companies.
- B. Company M's directors are experts at improving companies' profitability.
- C. It will be cheaper to buy a takeover target in an unrelated industry.
- D. There are more potential targets for conglomerate acquisition.

Q. 28

Instructions to candidates:

Select **TWO (2)** options.

Question:

Company X is a listed UK company seeking growth opportunities and has substantial financial resources.

It is considering the acquisition of Company Y which is of a similar size and is also UK listed.

The two companies are direct competitors having the same product range but with different brand names.

Which **two** statements are correct?

Options:

- A. If the directors of Y reject the approach, then the acquisition cannot proceed.
- B. The two companies will be combined into a new legal entity with a new name.
- C. If the directors of Y react positively than X can undertake detailed due diligence.
- D. As no additional finance is needed X does not require approval from its shareholders.
- E. After the acquisition X can benefit from the reduction of duplicated activities.

Q.29

Instructions to candidates:

Select from the drop-down menus to complete the sentences.

Question:

This information relates to Company Y:

- Capital structure: 50% equity and 50% debt.
- Return on equity: 7.0%
- Risk free rate: 3.0%
- Gross cost of debt: 4.5%
- Net cost of debt: 3.8%

Company Y's weighted average capital structure (WACC) is .

If Company Y's beta increases then its WACC will .

Q.30

Instructions to candidates:

Select **ONE (1)** option.

Question:

This information relates to Company X:

Equity Market Value: £6,000,000

Debt Market Value: £4,000,000

Risk Free Rate of Return: 2%

Market Return: 7%

Company Beta: 1.2

Company Cost of Debt: 8%

Tax Rate: 25%

Calculate Company X's weighted average cost of capital (WACC).

Options:

- A. 8.00
- B. 7.44
- C. 7.20
- D. 6.80

Q.31

Instructions to candidates:

Select **ONE (1)** option.

Question:

A company is considering the introduction of a new product, Product B, to replace an existing product, Product A.

The table lists the annual revenues and costs associated with Products A and B.

	Amount (£000)	
	Product B (estimated)	Product A (actual)
Revenue	350	250
Running Costs	150	120
Depreciation (included in running costs)	10	8
Board supervision	11	11
Advertising	20	0

Determine the annual cash flow to be used in the calculation of the present value of the introduction of Product B.

Options:

- A. £50,000
- B. £52,000
- C. £41,000
- D. £70,000

Case Study 1 (Q.32-35)

Instructions to candidates:

This scenario applies to the next four (4) questions (Q.32-Q.35).

Scenario:

Company J is a quoted bicycle retailer.

Company J's Board is considering expanding by investing in car dealerships.

This information relates to Company J's current finances:

	Cost of finance	Book value	Market value
Equity	24.0%	\$40 million	\$90 million
Borrowings	10.0%	\$35 million	\$30 million

Company J pays tax at 28%.

Q.32 (case study)

Instructions to candidates:

Select **ONE (1)** option.

Question:

What is Company J's weighted average cost of capital (WACC)?

Options:

- A. 16.2%
- B. 17.5%
- C. 19.8%
- D. 20.5%

Q.33 (case study)

Instructions to candidates:

Consider both Statement 1 and Statement 2 and decide, for each statement, whether it is true or false.

If, and only if, you consider both statements to be true, you must decide whether Statement 2 is a valid explanation as to why Statement 1 is true.

Select **ONE (1)** option.

Question:

Statement 1 (Assertion)		Statement 2 (Reason)
Company J's WACC is suitable for use as the required rate of return on the car dealerships.	because	WACC reflects the risks perceived by providers of finance.

Options:	Statement 1 (Assertion)	Statement 2 (Reason)	Is Statement 2 a valid explanation for Statement 1?
A.	True	True	Yes, Statement 2 is a valid explanation to support Statement 1.
B.	True	True	No, Statement 2 is NOT a valid explanation to support Statement 1.
C.	True	False	Not applicable because Statement 2 is false.
D.	False	True	Not applicable because Statement 1 is false.
E.	False	False	Not applicable because both Statements are false.

Q.34 (case study)

Instructions to candidates:

Select from the drop-down menus to complete the sentences.

Question:

Company J should consider evaluating this investment using the capital asset pricing model (CAPM). This has the advantage of allowing for

A suitable beta coefficient should be determined by obtaining the beta for a _____ adjusting to determine the company's

The resulting beta can then be used to determine

Q.35 (case study)

Instructions to candidates:

Select **THREE (3)** options.

Question:

Which **three** statements are specific risks that would arise in the car dealership venture?

Options:

- A. The price of crude oil could increase.
- B. A new model of car could have quality problems.
- C. The cost of motoring insurance could rise.
- D. Interest rates could rise.
- E. Rates of income tax could decrease.
- F. A factory fire could delay deliveries.

Q.36

Instructions to candidates:

Select **TWO (2)** options.

Question:

Company L publishes newspapers.

Company L's directors are evaluating a project to publish a fashion magazine.

Company L's beta is 1.2.

Company U, which is a major quoted magazine publisher has a beta of 0.9.

Which **two** statements are correct?

Options:

- A. The project's required rate of return should be based on a beta of 1.2.
- B. The project's required rate of return should be based on an ungeared beta.
- C. Using a lower beta decreases the likelihood of accepting the project.
- D. L's shareholders are affected by the risks as reflected in the project's beta.
- E. Company U's beta will not be readily available to L's Board.

Q. 37

Instructions to candidates:

Select from the drop-down menus to complete the sentences.

Question:

Company D is proposing to invest in a project to mine a rare mineral in a foreign country.

This project is to be evaluated using Monte Carlo simulation because the factors that will determine its success are

The model will be run many times until the average return becomes

If the simulation yields a positive net present value at least 55% of the time, then the investment should be

The range and variance of simulated outcomes reflect the

Q.38

Instructions to candidates:

Match each accounting ratio to its corresponding user by drawing a line between them.

Each option can only be used once.

Question:

Accounting ratio		Most interested user	
A.	Return on capital employed	(i)	Wholesale customers
B.	Gross profit %	(ii)	Suppliers
C.	Gearing	(iii)	Shareholders
D.	Quick asset ratio	(iv)	Lenders

Q.39

Instructions to candidates:

Select **TWO (2)** options.

Question:

Company S has several factories, all located overseas in low-wage countries.

The company's annual report gives a detailed description of employment and remuneration practices at those factories, despite there being no legal requirement to do so.

Which **two** statements best explain why Company S published this information?

Options:

- A. To reassure overseas governments that workers are treated fairly.
- B. To inform workers that their health and safety is a priority.
- C. To assure shareholders that profits are earned responsibly.
- D. To ensure that Company S pays fair wages and treats workers well.
- E. To minimise the risk of false accusations of exploitation.

Q.40

Instructions to candidates:

Select **ONE (1)** option.

Question:

Which option describes an integrated report?

Options:

- A. A comprehensive report on past performance and future prospects.
- B. A detailed set of accounts that allows totals to be broken down into segments.
- C. A financial statement supported by detailed comments on the figures.
- D. A non-financial statement for stakeholders who lack technical expertise.

Q.41

Instructions to candidates:

Match each scenario to its corresponding audit report by drawing a line between them.

Each option can only be used once.

Question:

Scenario	
A.	The auditors required additional information about the sales of Company W. Company W's managers are unable to provide it. The auditors are satisfied that apart from the uncertainty concerning sales, the accounts represent a true and fair view.
B.	Company X has disclosed in the notes to its accounts that there is uncertainty over the value of the investments it holds. The auditor is satisfied that the accounts represent a true and fair view.
C.	Company Y's directors have been uncooperative and have refused to supply the auditor with a significant amount of information required in their audit of financial statements, despite repeated requests. The auditor has been unable to complete the audit.
D.	The auditors fundamentally disagree with how the Company Z has valued many of its assets. The auditors hold the opinion the accounts do not give a true and fair view.

Audit report	
(i)	Unqualified opinion
(ii)	Emphasis of matter
(iii)	Adverse opinion
(iv)	Qualified opinion
(v)	Disclaimer of opinion

Q.42

Instructions to candidates:

Select **TWO (2)** options.

Question:

Company X is a UK company listed on the London Stock Exchange and produces its accounts as required by regulation.

A trainee analyst has been provided with the statement of financial position, the statement of comprehensive income, the cash flow statement and the notes to the accounts.

The analyst has been asked to prepare a detailed investment review of Company X.

Which **two** statements are correct?

Options:

- A. The statement of financial position will enable a relevant asset value per share to be calculated accurately.
- B. The statement of comprehensive income is the same as the statement of profit and loss.
- C. The cash flow statement will explain changes in the company's bank balance over the year.
- D. The analyst should focus on the three statements since the notes will have only limited information.
- E. The statement of comprehensive income will enable profit margins to be calculated at three levels.

Q.43

Instructions to candidates:

Select **ONE (1)** option.

Question:

Company P's accountant is preparing the company's financial statements.

It has been discovered that a clerical error led to the depreciation charge being understated.

Which of the following describes the impact on the financial statements of correcting this error?

Options:

- A. Profit will decrease and non-current assets will decrease.
- B. Profit will decrease and non-current assets will increase.
- C. Profit will increase and non-current assets will decrease.
- D. Profit will increase and non-current assets will increase.

Q.44

Instructions to candidates:

Select **TWO (2)** options.

Question:

Which **two** reasons best explain the usefulness of cash flow statements alongside other financial statements?

Options:

- A. They provide a valuable statement of a company's financial position.
- B. They indicate whether cash balances have increased or decreased.
- C. They provide an explanation of the reasons for changes in cash.
- D. They indicate whether the board has managed cash effectively.
- E. They enable shareholders to see how fresh finance has been used.

Q.45

Instructions to candidates:

Select **ONE (1)** option.

Question:

Which statement best describes the problems associated with preparing insurance company accounts.

Options:

- A.** Forecasting errors frequently lead to excessive dividend payments that can threaten financial stability.
- B.** The size of liabilities can be accurately determined at the outset of new contracts, so additional provisions should not be required.
- C.** If lots of new contracts are written in any given year then the setting up costs could depress profits.
- D.** Uncertainty about costs could lead to overcautious estimates, leading to the overstatement of profits.

Q.46

Instructions to candidates:

Select **TWO (2)** options.

Question:

This table shows Company X's holdings in the voting shares of other companies.

Company	Voting Shares Holding (%)	Voting Board Seats controlled by X
A	100	8 out of 8
B	60	4 out of 7
C	45	1 out of 6
D	30	4 out of 7
E	10	1 out of 9

The Chief Financial Officer is preparing the X Group's consolidated financial statements.

Which **two** statements are correct?

Options:

- A.** Only the results of Company A should be fully consolidated in the financial statements since the other companies are not fully owned.
- B.** 60% of the results of Company B should be consolidated in the financial statements since that is the extent of its holding.
- C.** 45% of results of Company C should be included as a single line item within the total attributable to associates.
- D.** The results of Company D should be fully consolidated in the financial statements with non-controlling interest shown separately.
- E.** 10% of results of Company E should be included as a single line item within the total attributable to associates.

Q.47

Instructions to candidates:

Select **THREE (3)** options.

Question:

These statements of financial position relate to Hold and its 80% subsidiary Sub.

	Hold \$ millions	Sub \$ millions
Investment in Sub	120	-
Plant and equipment	100	40
Trade receivables	10	6
Bank	4	3
Total assets	234	49
Share capital and reserves	225	41
Trade payables	9	8
Total equity and liabilities	234	49

Hold's trade receivables include \$2 million receivable from Sub.

Which **three** statements are correct with respect to the Hold Group's consolidated statement of financial position?

Options:

- A. Plant and equipment will have a book value of \$132 million.
- B. Bank will have a book value of \$7 million.
- C. Trade receivables will be \$14 million.
- D. Trade payables will be \$17 million.
- E. A goodwill figure will be inserted to make the statement balance.
- F. Investment in Sub will appear as a financial asset.

Q.48

Instructions to candidates:

Select **ONE (1)** option.

Question:

Company G's statement of financial position is:

	\$ million
Intangible assets	200
Property, Plant and Equipment	700
Current assets	<u>150</u>
	<u>1,050</u>
Equity	400
Loan capital	550
Current liabilities	<u>100</u>
	<u>1,050</u>

Calculate the asset cover on G's loan capital.

Options:

- A. 1.1 times
- B. 1.4 times
- C. 1.5 times
- D. 1.7 times

Q.49

Instructions to candidates:

Calculate to the nearest whole number and enter it in the box.

Question:

This information relates to Company Q:

Profit before interest and tax	220,000
Interest on loan capital	<u>(22,000)</u>
Profit before tax	198,000
Tax (10%)	<u>(19,800)</u>
Profit after interest and tax	178,200

Calculate Company Q's interest cover to the nearest whole number.

Q.50**Instructions to candidates:**

Select **ONE (1)** option.

Question:

This information has been obtained from the annual accounts of Company X:

	£'000
Profit before interest and tax	4,000
Interest on loan capital	<u>(900)</u>
Profit before tax	3,100
Tax (20%)	<u>(620)</u>
Profit after interest and tax	2,480

Company X has three loans outstanding, each with a different bank. The loans are priority ranked as follows:

Priority	Bank	Annual loan interest (£'000)
1	A	450
2	B	250
3	C	200

Calculate the interest rate cover for the loan from Bank B, taking into account the priority ranking.

Options:

- A. 5.7 times
- B. 16.0 times
- C. 14.2 times
- D. 5.1 times

Q.51

Instructions to candidates:

Select **ONE (1)** option.

Question:

This information is from Company Y's recently published financial statements.

Asset gearing: **80%**

Earnings per share (EPS): **4.5p**

Profit margin: **20%**

Income gearing: **50%**

Interest rates on the company's variable rate borrowings have increased and the directors wish to know how that will affect the ratios.

Which option shows the most likely impact of an increase in interest rates for this Company?

Options:

- A. Profit margin: unchanged
Income gearing: fall
- B. Profit margin: fall
Income gearing: rise
- C. Profit margin: unchanged
Income gearing: rise
- D. Profit margin: rise
Income gearing: rise

Q.52

Instructions to candidates:

Select **ONE (1)** option.

Question:

An investment manager is considering making an investment in Company H.

This information relates to Company H:

- Current share price \$2.20
- Earnings per share \$0.60 (based on last year's financial statements)
- Diluted earnings per share \$0.50 (based on last year's financial statements)
- Forecast earnings per share \$0.70 (based on predictions of the results due for publication)
- Forecast diluted earnings per share \$0.58 (based on predictions of the results due for publication)
- Diluted earnings per share allows for the effects of convertible loan stock that will be exercised in 5 years

Calculate Company H's price earnings ratio.

Options:

- A.** 3.1
- B.** 3.7
- C.** 3.8
- D.** 4.4

Q.53

Instructions to candidates:

Select **TWO (2)** options.

Question:

Which **two** statements explain why analysts calculate EBITDA?

Options:

- A. EBITDA simplifies the calculation of accounting ratios.
- B. Amortisation is not an expense that affects performance.
- C. Operating profit reflects a company's management skills.
- D. Fewer assumptions lead to more comparable ratios.
- E. Analysts have a limited understanding of depreciation.

Q.54

Instructions to candidates:

Select **TWO (2)** options.

Question:

Which **two** of the following statements relating to net earnings per share (EPS) are correct?

Options:

- A. Earnings should be calculated before corporation tax.
- B. Preference dividends should be subtracted from profit.
- C. Shareholders should focus on EPS rather than profit.
- D. The number of shares should allow for share issues during the year.
- E. Investment analysts must use a specific formula for EPS.

Q.55

Instructions to candidates:

Consider both Statement 1 and Statement 2 and decide, for each statement, whether it is true or false.

If, and only if, you consider both statements to be true, you must decide whether Statement 2 is a valid explanation as to why Statement 1 is true.

Select **ONE (1)** option.

Question:

You have been provided with this information about Company A and Company B:

	Company A	Company B
Inventory Turnover Period	45 days	30 days
Trade Receivables Period	50 days	40 days
Trade Payables Turnover Period	40 days	35 days
Revenue	\$120,000	\$150,000
Cost of sales	\$100,000	\$125,000

Statement 1 (Assertion)		Statement 2 (Reason)
Company A has a greater need for an injection of cash compared to Company B.	because	Company A has a lower operating profit compared to Company B.

Options:	Statement 1 (Assertion)	Statement 2 (Reason)	Is Statement 2 a valid explanation for Statement 1?
A.	True	True	Yes, Statement 2 is a valid explanation to support Statement 1.
B.	True	True	No, Statement 2 is NOT a valid explanation to support Statement 1.
C.	True	False	Not applicable because Statement 2 is false.
D.	False	True	Not applicable because Statement 1 is false.
E.	False	False	Not applicable because both Statements are false.

Q.56

Instructions to candidates:

Select **THREE (3)** options.

Question:

Airline D has just published its annual report.

An analyst who specialises in the airline industry has been tasked with undertaking a full analysis of Airline D's financial results.

The analyst has calculated Airline D's return on capital employed (ROCE), and the result is significantly higher than expected.

Which **three** of the following statements are correct?

Options:

- A. Airline D's asset utilisation and profit margin ratios should be calculated.
- B. The cash flow statement will help confirm the credibility of profits.
- C. The analyst should disregard ROCE if it cannot be explained.
- D. Airline D's acquisition of new planes during the year would increase its ROCE.
- E. The analyst should study the report by Airline D's external auditor.
- F. It is not appropriate to calculate ROCE in respect of an airline.

Case Study 2 (Q.57-60)

Instructions to candidates:

This scenario applies to the next four (4) questions (Q.57-Q.60).

Scenario:

Company A is a quoted company that manufactures laptop computers.

Q.57(case study)

Instructions to candidates:

Select **TWO (2)** options.

Question:

Which **two** statements would cause an increase in Company A's inventory turnover period (measured in days)?

Options:

- A. A recent large sale to a government department.
- B. The retention of obsolete components, valued at cost.
- C. Payment in advance for an order of batteries not yet delivered.
- D. Advance production of a new model of laptop prior to its launch.
- E. The donation of surplus laptops to a charity, free of charge.

Q.58 (case study)

Instructions to candidates:

Select from the drop-down menus to complete the sentences.

Question:

Company A received a very large order from an overseas retailer, shortly before A's year end.

Company A demanded an immediate deposit of \$20,000 to secure the order.

This deposit will increase company A's trade turnover measured in days.

The turnover return to normal once the order has been fulfilled.

There will be an immediate in Company A's working capital cycle when the customer's payment is received.

Q.59 (case study)

Instructions to candidates:

Select **THREE (3)** options.

Question:

According to the draft financial statements that are due to be published, Company A's working capital cycle (WCC) has increased by 20 days since last year. The Board is concerned about the market's reaction.

Which **three** statements are correct?

Options:

- A. A long WCC prevents liquidity problems.
- B. An increase in WCC suggests inefficiencies in Company A's Board.
- C. An increase in WCC will reduce Company A's return on capital employed.
- D. An increase in WCC is of little interest to Company A's shareholders.
- E. The increase to WCC is of particular concern if inventory has increased.
- F. Company A's Board should alter the figures to reduce the WCC.

Q.60 (case study d)

Instructions to candidates:

Consider both Statement 1 and Statement 2 and decide, for each statement, whether it is true or false.

If, and only if, you consider both statements to be true, you must decide whether Statement 2 is a valid explanation as to why Statement 1 is true.

Select **ONE (1)** option.

Question:

According to the draft financial statements due to be published, Company A's working capital cycle has increased by 20 days since last year.

Most of that increase is due to Company A settling trade payables more quickly. Suppliers typically grant 30 days to settle invoices.

Company A currently settles invoices after 40 days, compared to 55 days previously.

Statement 1 (Assertion)		Statement 2 (Reason)
Company A's cash balance would increase if it delayed payments to suppliers by an additional 20 days.	because	Suppliers do not make a separate charge for extended trade credit.

Options:	Statement 1 (Assertion)	Statement 2 (Reason)	Is Statement 2 a valid explanation for Statement 1?
A.	True	True	Yes, Statement 2 is a valid explanation to support Statement 1.
B.	True	True	No, Statement 2 is NOT a valid explanation to support Statement 1.
C.	True	False	Not applicable because Statement 2 is false.
D.	False	True	Not applicable because Statement 1 is false.
E.	False	False	Not applicable because both Statements are false.

Q.61

Instructions to candidates:

Select from the drop-down menus to complete the sentences.

Question:

Company H manufactures electronic components.

Company H has a very short inventory turnover period (in days).

Such a short period is _____ a favourable sign.

Company H's Board should be careful not to _____ by carrying
_____ inventory.

The optimal inventory turnover

Q.62

Instructions to candidates:

Select from the drop-down menus to complete the sentences.

Question:

Company S is located in a country that is experiencing high inflation.

This means that Company S's historical cost profit has been

If an item of inventory is purchased for \$2.00 and sold for \$3.00, reporting profit of \$1.00 ignores the fact that the

Depreciation will be based on cost figures that are

Company S has borrowed heavily.

The impact of inflation on the amount borrowed will Company S.

Q.63

Instructions to candidates:

Match each reason to its corresponding method by drawing a line between them.

Each option can only be used once.

Question:

Company M's directors wish to manipulate their published financial statements.

Match each reason for manipulating financial statements to a method that will provide the desired result.

Reason		Method	
A.	Increase reported profit	(i)	Delay the recording of sales made before the year end to the next financial year.
B.	Reduce taxable profit	(ii)	Recognise an optimistic revaluation of property.
C.	Minimise perceptions of risk	(iii)	Make an optimistic assumption of the economic lives of tangible assets.
D.	Reduce gearing	(iv)	Ignore contingent liabilities.

Q.64

Instructions to candidates:

Match each scenario to its corresponding budgeting approach by drawing a line between them.

Each option can only be used once.

Question:

Scenario		Budgeting approach	
A.	Senior management relies heavily on the technical expertise of the management team that supervises the Health and Safety Department to identify targets and future expenditure.	(i)	Top Down Budgeting
B.	Senior sales managers in a manufacturing company are concerned that the junior management team lacks ambition in forward planning.	(ii)	Zero Based Budgeting
C.	Senior managers in a technology company are concerned that the company constantly makes significant investments of time and money on staff training, with little attention paid to the benefits.	(iii)	Incremental Budgeting
D.	The sales manager in a car dealership is concerned that the members of the sales team usually achieve their targets, but rarely exceed them.	(iv)	Beyond Budgeting
		(v)	Bottom Up Budgeting

Q.65

Instructions to candidates:

Select **ONE (1)** option.

Question:

An actuarial consultancy is budgeting for the year ahead.

Its office can accommodate 120 actuaries.

It has sufficient work to keep 110 actuaries occupied.

The consultancy has never been able to maintain a workforce of more than 90 actuaries.

Each actuary generates \$250,000 of billable hours each year.

Salaries, expenses and other costs are \$90,000 per actuary.

Last year's profit was \$12.0 million.

The consultancy's profits have tended to grow at 10% per annum.

Calculate the consultancy's budgeted profit.

Options:

- A. \$13.2 million
- B. \$14.4 million
- C. \$17.6 million
- D. \$19.2 million