

CIMA F3 Study Text errata & clarification

August 2015

F3 Study Text Errata (1st edition)

Practice Question Bank, Ch 9, Q1 and Q2 – 2012 should read 20Y2.

F3 Study Text Errata (1st and 2nd editions)

Ch 7, Sec 2.3 – the solution should include a balancing charge for the trade-in value as follows:

The present value (PV) of purchase costs

<i>Year</i>	<i>Item</i>	<i>Cash flow</i>	<i>Discount factor</i>	<i>PV</i>
0	Equipment cost	\$ (20,000)	9% 1.000	\$ (20,000)
2	Tax savings, from allowances 30% x \$20,000	6,000	0.842	5,052
5	Trade-in value	4,000	0.650	2,600
6	Balancing charge 30% x \$4,000	(1,200)	0.596	(715)
			NPV of purchase	<u>(13,063)</u>

Ch 10, Q10.1 and Q10.2 – learning outcome should read C(1)(a).

F3 Study Text Errata (2nd edition)

Practice question bank, Ch 12, Q3 – question should read as follows:

What cost of capital should be used as a discount rate for the valuation of Pet Stop Ltd?

- A 8.8%
- B 8.5%
- C 4.7%
- D 7.5%

Practice question bank, Ch 12, Q3 – The second paragraph should read: ‘Pet stop has a debt: equity ratio of 1:3, and a post-tax cost of debt of 7%.’

Practice answer bank, Ch 12, Q3 – The last two steps of the computation should read as follows:

$$= 9.04 \left[\frac{3}{4} \right] + 7 \left[\frac{1}{4} \right]$$

$$= 8.5\%$$

Ch 3, Sec 1.4.6 – the existing example in the Study Text is incorrect and has been changed to the following (This supersedes the existing example in the Study Text.):

1.4.6 Example: Hedge of a net investment in a foreign operation

On 1 January 20X6, Company A, whose functional currency is \$, acquired a 100% interest in a foreign subsidiary, Company B, whose functional currency is €. Under the terms of the acquisition, Company A purchased the net assets and goodwill of Company B for €800,000.

Company A financed the acquisition by taking out a € loan on 1 January 20X6 for €800,000 in order hedge exchange rate fluctuations.

The following additional information is available:

	<i>01/01/X6</i>	<i>31/12/X6</i>
Spot rate	\$1: €1.45	\$1: €1.50

Required

Show the double entries relating to the retranslation of the € loan in the consolidated financial statements at 31 December 20X6. Assume that the € loan was designated as a hedge at 1 January 20X6.

Solutio

Gain on retranslation of loan

\$

Loan at 1.01.X6 (€800,000/1.45)	551,724
Loan at 31.12.X6 (€800,000/1.50)	<u>533,333</u>
Gain on retranslation	<u>18,391</u>

Since the investment in the net assets of Company B is also €800,000, there is an equal loss on the retranslation of the investment of \$18,391.

In accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*, the loss on the retranslation of the investment is recognised in other comprehensive income in the consolidated financial statements.

The hedge effectiveness is $\$18,391 \div \$18,391 = 100\%$. The hedge is therefore **highly effective** as the hedge effectiveness is between 80% and 120%. Furthermore, the loan was designated as a hedge at inception, so the conditions for hedge accounting to apply to the gain on the loan have been met. The hedge is also **fully effective** as all of the gain on the loan is used in offsetting the loss on the foreign investment. Therefore the full amount of the gain on the loan is credited to other comprehensive income.

DEBIT Financial liability	\$18,391	
CREDIT Other comprehensive income		\$18,391

F3 Study Text Update (1st and 2nd editions)

Ch 8, Sec 4.5 – supplementary example of a dividend valuation calculation with non-constant growth rates:

Supplement: Example: Dividend valuation - non-constant growth

It is 1 January 20X1. ABC Co paid a dividend last year of \$100,000. Dividends are expected to grow at 5% over the next 2 years, and then 3% thereafter. The cost of capital of ABC Co is 9%. Assume cash flows will occur at the end of the year.

Required

Calculate a dividend valuation of ABC Co.

Solutio

Phase 1

<i>Time</i>	<i>31/12/X1</i> <i>(T₁)</i>	<i>31/12/X2</i> <i>(T₂)</i>
	\$	\$
Dividend (growth at 5%)	105,000	110,250
Discount factor @ 9%	<u>0.917</u>	<u>0.842</u>
PV at 01/01/X1 (T ₀)	96,285	92,831
Total = \$189,116		

Phase 2

Dividend from T₃ onwards \$110,250 × 1.03 = \$113,558
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$$P_0 = \frac{d_1}{K_e - g} \text{ is adapted to } P_2 = \frac{d_3}{K_e - g}$$

$$P_2 = \frac{113,558}{0.09 - 0.03} = \$1,892,633$$

Then discounting at a T₂ discount factor of 0.842 = \$1,892,633 × 0.842 = \$1,593,597

Total = \$189,116 + \$1,593,597 = \$1,782,713