

The Accounting Case Competition for Secondary Schools and Tertiary Institutes

2004

Secondary Schools Group

Time allowed - 2 hours

Answer ALL the questions

	<i>Marks</i>
Section A	80
Section B	<u>20</u>
	<u>100</u>

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INSTRUCTED TO DO SO BY THE SUPERVISOR**

ALL questions in this paper are compulsory and MUST be answered. They are worth a total of 100 marks.

In answering the questions, you should refer to the Annual Report, and quote references from the Annual Report with their page numbers as far as possible. Figures should be given to one decimal place.

Section A: Case Study (80%)

Cathay Pacific Airways is an international airline registered and based in Hong Kong, offering scheduled cargo and passenger services to over 80 destinations around the world. Though severely disrupted by the SARS outbreak, which resulted in a steep decline in passenger demand and several months of heavy losses, the firm was able to return to profitability in the year ended 31 December 2003 when it made an attributable profit of HK\$1,303 million. J Airlines, another Asian based company, however, saw its sales revenues fall by 7.3%, and the company suffered an operating loss of around US\$600 million.

REQUIRED:

Question 1 – Annual Reports Survey

Read the Annual Report of Cathay Pacific Airways for the year ended 31 December 2003 and compile a ratio analysis report with reference to J Airline's, as given. Compile a SWOT analysis based on your ratio interpretation and the significant events presented in the directors' reports. The following guide will help you.

Ratio Analysis Report

Ratio	Cathay	JA	Interpretation and limitations
Profitability			
Net profit margin		-6.6%	
ROCE <i>(based on the ratio of profit before tax to total capital)</i>		-2.5%	
Earnings per share <i>(based on the ratio of profit after tax and preference share dividend to number of ordinary shares ranking for dividend)</i>		N/A	
Dividend cover		N/A	
Liquidity and debt management			
Current ratio		0.33/1	
Interest cover		N/A	
Gearing <i>(based on the ratio of fixed charge capital to total capital)</i>		44%	
Total debt to equity		83%	
Asset management			
Debtors ratio (days)		34 days	
Fixed asset turnover		43%	

Area of concern	Descriptions
Strengths	
Weaknesses	
Opportunities	
Threats	

(30 marks)

Question 2 – Business Policy Blue Print

Cathay Pacific Airways may have benefited from a boom in the local tourist market and a successful campaign in extending services to different parts of the world by means of negotiation and collaboration with overseas partners. However, given the keen competition in the Southeast Asia region, threats in political conflicts, and fluctuations in fuel costs, it will be harder to ensure steady growth in the years ahead. You are therefore asked to draft a business policy for the firm as a guide for sustained growth.

	Proposed Business Policy of Cathay Pacific Airways
Product	
Marketing	
Financial	
Management	

(15 marks)

Question 3 – Strategy Review: Heavy Investment in Staff Training

From page 7 of the company's Annual Report, we are told that Cathay Pacific Airways has had its own training centre in Australia as from 1988. So far, some 200 pilots have graduated from this centre. Though heavy investment is required in running the centre, the company finds it essential as a precaution for further strike threats.

- (a) 'As investment in staff development will bring no immediate benefits, the heavy investment is therefore not justified.' Comment on this statement.
- (b) Will it help if the costs incurred are treated as a form of deferred asset and amortised later to match against revenues?

(10 marks)

Question 4 – Strategy Review: Measures in Cost Saving

In period of rising petrol prices, an increase in fuel cost seems to be inevitable. The company recorded an increase of 7% in its fuel costs last year. From page 34 of the Annual Report, we are told that fuel derivatives were used to reduce exposure to fluctuating fuel prices.

- (a) With reference to the information given above, explain how fuel derivatives can help reduce the company's exposure to fuel price fluctuations.
- (b) State other measures which may be effective in cost control.

(15 marks)

Question 5 – Strategy Review: Simultaneous Use of Finance Leases and Operating Leases

From page 47 of the Cathay Pacific Airways' Annual Report, we can see that a significant amount was spent on operating lease rentals for aircraft and related equipment. In addition to that, the company invested quite a large sum buying aircraft and acquiring them using finance leases.

- (a) Distinguish between finance leases and operating leases.

Finance lease	
Operating lease	

- (b) Why is it good to acquire the use of aircraft through these two different finance methods?

(10 marks)

(Total 80 marks)

Section B: Technical Problems (20%)

Hong Kong Statements of Standard Accounting Practice (HKSSAPs) are frequently updated to cope with new trends in the business sector and to comply with international standards. Some technical updates are found in the Cathay Pacific Airways' Annual Report.

REQUIRED:

Question 6 – Treatment of Goodwill

How will Cathay Pacific Airways treat purchased goodwill? How does this differ from the written-off against reserves method, and why has there been a change in the method used by the company?

(10 marks)

Question 7 – Depreciation Policy

From page 32 of the Annual Report, we are told that the depreciation policy and the carrying amount of fixed assets were reviewed annually taking into consideration factors which affect the life expectancy of the assets. Does this violate the concept of consistency?

(10 marks)

(Total 20 marks)

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(QUESTIONS)

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