

The Accounting Case Competition for Secondary Schools and Tertiary Institutes

2004

Tertiary Institutes Group

Time allowed – 2 hours

Answer ALL the questions

	<i>Marks</i>
Section A	50
Section B	20
Section C	15
Section D	<u>15</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 (50%)

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 its operations were 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 with an attributable profit of HK\$1,303 million in the year ended 31 December 2003. J Airlines, another Asian based company, however, saw its sales revenues fall by 7.3%, and the company generated an operating loss of around US\$600 million.

Question 1

The following is a summary on seats available for two types of aircrafts:

Aircraft Type	First Class	Business Class	Economy Class
B747-400	12	45	324
B777-300	0	59	323

The following information relates to two flights operated by Cathay Pacific Airways on a particular day:

Flight Number	Aircraft Type	Sector	Sector Distance (km)	Passengers Carried #		
				First	Business	Economy
CX255	B747-400	Hong Kong - London	9,643	10	35	300
CX751	B777-300	Hong Kong - Bangkok	1,712	0	50	310
		Bangkok - Bombay	3,006	0	30	155
		Bombay - Dubai	1,925	0	5	240

#: The figures are for illustrative purposes only.

REQUIRED:

Calculate the amount of available seat kilometres (ASK) for these two flights.

(5 marks)

Question 2

Available seat kilometres (ASK), available tonne kilometres (ATK), revenue passenger kilometres (RPK) and revenue tonne kilometres (RTK) are measures commonly used in the aviation industry to evaluate the performance of airlines. The first three of these measures are periodically disclosed by Cathay Pacific Airways to the general public through the company's website.

The following schedule summarises the measures disclosed (in thousands) from January 2004 to September 2004:

	Jan 04	Feb 04	Mar 04	Apr 04	May 04	Jun 04	Jul 04	Aug 04	Sep 04
ASK	6,032	5,545	5,929	5,824	6,009	5,910	6,463	6,480	6,186
ATK	1,263	1,181	1,315	1,225	1,281	1,228	1,345	1,365	1,331
RPK	4,779	4,032	4,361	4,486	4,466	4,710	5,255	5,200	4,654

RTK is not disclosed in the website or the company's Interim Report, but is disclosed in the Annual Report only.

REQUIRED:

- (a) Restricting your analysis to ASK, ATK and RPK only, comment on the progress of Cathay Pacific Airways from January 2004 to September 2004 when compared with its performance disclosed in the Annual Report for 2003.
- (b) State, with elaboration, one possible reason why RTK is not disclosed by Cathay Pacific Airways.

(20 marks)

Question 3

"EBITDA per share" and "net debt/equity ratio" were shown as \$1.87 and 0.36 times respectively in the Annual Report for 2003.

REQUIRED:

- (a) Show how the figures of \$1.87 and 0.36 times were calculated.
- (b) Explain the importance of EBITDA and the net debt/equity ratio.

(10 marks)

Question 4

The following “Financial and Operating Highlights” were disclosed in Cathay Pacific Airways’ Interim Report for 2004:

Group Financial Statistics

		2004	2003
Results		Six months ended	30th June
Turnover	\$ million	18,185	12,275
Profit/(loss) attributable to shareholders	\$ million	1,771	(1,241)
Earnings/(loss) per share	HK cents	52.8	(37.2)
Dividend per share	HK cents	20.0	3.0
Profit/(loss) margin	%	9.7	(10.1)
Balance Sheet		30th June	31st December
Shareholders’ funds	\$ million	31,792	31,052
Net borrowings	\$ million	10,252	11,111
Shareholders’ funds per share	\$	9.4	9.3
Net debt/equity ratio	Times	0.32	0.36

Operating Statistics - Cathay Pacific Airways

		Six months ended	30th June
Available tonne kilometres (ATK)	Million	7,493	6,087
Passengers carried	'000	6,404	4,019
Passenger load factor	%	76.1	64.4
Passenger yield	HK cents	45.7	42.8
Cargo carried	'000 tonnes	470	406
Cargo and mail load factor	%	68.7	69.2
Cargo and mail yield	\$	1.72	1.72
Cost per ATK	\$	2.07	2.09
Cost per ATK without fuel	\$	1.62	1.70
Aircraft utilisation	Hours per day	11.7	11.1
On-time performance	%	91.2	91.7

REQUIRED:

Comment on the performance of Cathay Pacific Airways in the first six months of 2004 (comparing it with performance in the first six months of 2003) in terms of:

- (a) **operating results**
- (b) **financial position**
- (c) **productivity and cost management**

(15 marks)

(Total 50 marks)

Section B: Strategy Review (20%)

Question 5

Should Cathay Pacific Airways expand its cargo services operations?

The 2003 Annual Report claimed that this had been a good year for cargo services, both in terms of revenue and freight tonnage. Growth was driven by demands for goods exported through Hong Kong to markets in Europe, Japan and the United States. The war in the Middle East had no effect on cargo operations. In 2003, cargo revenue contributed 33.5% to Group turnover.

REQUIRED:

Do you think it is good for Cathay Pacific Airways to expand its cargo services operations?
(10 marks)

Question 6

Should Cathay Pacific Airways expand its passenger traffic operations in mainland China?

Fatal diseases such as bird flu and SARS are common in the Asia region, including mainland China. The 2003 Annual Report claimed that Cathay Pacific Airways' operations were severely disrupted by the SARS outbreak, which resulted in a steep decline in passenger traffic. However, the report stated that the company resumed services to Beijing on 2 December 2003: it has also been granted licences to operate services to Shanghai and Xiamen.

REQUIRED:

With reference to the information given above, comment on the rationale for Cathay Pacific Airways resuming passenger traffic operations in the mainland.
(10 marks)

(Total 20 marks)

Section C: Current Issue (15%)

Question 7

The rapid rise of oil prices and staff costs has had an adverse effect on profits in the airline industry. You are required to recommend actions that Cathay Pacific Airways should take in order to minimise this adverse effect. You should justify your proposals. If you use information contained in the company's Annual Report, you should quote its reference and page number.

(15 marks)

Section D: Technical Problems (15%)

Question 8

- (a) Explain the importance of disclosure of principal accounting policies in an annual report.
- (b) From the 2003 Cathay Pacific Airways Annual Report, we can see that modifications to aircraft and reconfiguration costs are capitalised as part of aircraft costs. What are the conditions needed for expenditure to be capitalised?
- (c) Also from the 2003 Annual Report, we see that stock held for disposal is stated at the lower of cost and net realisable value. Explain the rationale behind this policy.

You should quote reference from relevant accounting frameworks, HKSSAPs and accounting concepts where appropriate.

(15 marks)

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(QUESTIONS)

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