

**PAPER 2 MANAGEMENT ACCOUNTING AND FINANCIAL ANALYSIS
NOVEMBER 1997**

Answer any Five question.

Question 1

TSL Ltd., a highly profitable and tax paying company is planning to expand its present capacity by 100%. The estimated cost of the project is Rs.1,000 lakhs out of which Rs.500 lakhs is to be met out of loan funds. The company has received two offers from their bankers:

	Option 1	Option 2
Value of loan	Rs.500 lakhs	US \$ 14 lakhs equal to Rs.500 lakhs
Interest	15% payable yearly	6% payable (Fixed) yearly in US \$
Period	5 years	5 years
Repayment	(In 5 instalments. First installment is payable after draw down)	--
Other expenses (to be treated as revenue expenditure)	1% of the value of the loan	1% at US \$ = Rs.36 (Average)
Future exchange rate	--	End of 1 year 1US \$ = Rs.38 thereafter to increase by Rs.2 per annum.

The company is liable to pay Income Tax at 35% and eligible for 25% depreciation on W.D value. You may assume that at the end of 5th year the company will be able to claim balance in WDV for tax purposes. The company follows Accounting Standards – 11 for accounting changes in Foreign Exchange Rate

- (1) Compare the total outflow of cash under the above options.
- (2) Using discounted cash flow techniques, evaluate the above offers.
- (3) Is there any risk, which the company should take care of?
- (4) In case TSL has large volume of exports would your advice be different.

The following discounting table may be adopted:

Years	0	1	2	3	4	5
Discounting Factor	1	0.921	0.848	0.781	0.720	0.663

(20 Marks)

Question 2

- (a) The following details are available in respect of a firm:

- | | |
|---|-------------------|
| i. Annual requirement of inventory | 40,000 units |
| ii. Cost per unit (Other than carrying and Ordering Cost) | Rs.16 |
| iii. Carrying cost are likely to be | 15% per year |
| iv. Cost of placing order | Rs.480 per order. |

Determine the Economic Ordering Quantity.

- (b) The experience of the firm being out of stock is summarized below:

(1) Stock out (No. of units)	No. of times
500	1 (1)
400	2 (2)
250	3 (3)
100	4 (4)
50	10 (10)
0	80 (80)

Figures in brackets indicate percentage of time the firm has been out of stock.

- (2) Stock out costs are Rs.40 per unit is Rs.20.
 - (3) Carrying cost of inventory per unit is Rs.20
- Determine the optimal level of stock out inventory

- (c) A firm has 5 different levels in its inventory. The relevant details are given. Suggest a breakdown of the items into A, B and C classifications:

Item no.	Avg. No. of units inventory	Avg. Cost per unit
1	20,000	Rs.60
2	10,000	Rs.100
3	32,000	Rs.11
4	28,000	Rs.10
5	60,000	Rs.3.40

(6+8+6 = 20 Marks)

Question 3

- (a) The fixed assets and equities of Eastern Manufacturing Co. Ltd., are supplied to you both at the beginning and at the end of the year 1996-97:

	1.04.96	31.03.97
	Rs.	Rs.
Plant less Depreciation	63,500	1,42,500
Investment in Shares of Southern Manufacturing Company	1,32,000	2,90,000
Bond payable	2,50,000	70,000
Capital stock	4,00,000	4,00,000
Retained Earnings	2,38,000	4,10,500

You are not in a position to have complete Balance Sheet data or an income statement for the year in spite of the fact that you have obtained the following information:

- Dividend of Rs.37,500 were paid.
- The net income included Rs.13,000 as profit on sale of equipment. There has been an increase of Rs.93,000 in the value of gross plant assets even though equipments worth Rs.29,000 with a net book value of Rs.19,000 was disposed of.

From the particulars given above, prepare a statement of source and uses of net working capital.

- (b) The management of Up and Down Ltd., are worried about their increasing labour turnover in the factory and before analyzing the causes and taking remedial steps, they want to have an idea of the profit forgone as a result of labour turnover in the last year.

Last year sales amounted to Rs.83,03,300 and the P/V ratio was 20%. The total number of actual hours worked by the direct labour force was 4.45 lakhs. As a result of the delays by the personnel department in filling vacancies due to labour turnover 1,00,000 potentially productive hours were lost. The actual direct labour hours included 30,000 hours attributable to training new recruits, out of which half of the hours were unproductive.

An analysis of costs incurred consequent on labour turnover revealed the following:

	Rs.
Settlement cost due to Leaving	43,820
Recruitment costs	26,740
Selection costs	17,750
Training costs	30,490

Assuming that the potential lost as a consequences of labour turnover could have been sold at prevailing prices, find out the profit foregone last year on account of labour turnover.

(10+10=20 Marks)

Question 4

EITHER

- (a) From the following prepare Income Statement of Company A, B and C. Briefly comment on each company's performance:

Company	A	B	C
Financial leverage	3:1	4:1	2:1
Interest	Rs.200	Rs.300	Rs.1,000
Operating leverage	4:1	5:1	3:1
Variable cost as a percentage to sales	66 2/3%	75%	50%
Income tax rate	45%	45%	45%

- (b) X Ltd., a widely held company is considering a major expansion of its production facilities and the following alternatives are available:

	Alternatives (Rs. In lakhs)		
	A	B	C
Share capital	50	20	10
14% Debentures	-	20	15
Loan from a Financial Institution @ 18% p.a. Rate of Interest	-	10	25

Expected rate of return before tax is 25%. The rate of dividend of the company is not less than 20%.
The company at present has low debt. Corporate taxation 50%.

Which of the alternatives you would choose?

(12+8=20 Marks)

OR

- (a) The following information is available in respect of ABC Ltd.,

- Materials are purchased and received one month before being used and payment is made to suppliers two months after receipt of materials.
- Cash is received from customers three months after finished goods are sold and delivered to them.
- No time lag applies to payments of wages and expenses.
- The following figures apply to recent and future months:

Month	Materials received	Sales	Wages & Expenses
	Rs	Rs	Rs.
January	20,000	30,000	9,500
February	22,000	33,000	10,000
March	24,000	36,000	10,500
April	26,000	39,000	11,000
May	28,000	42,000	11,500
June	30,000	45,000	12,000
July	32,000	48,000	12,500
August	34,000	51,000	13,000

- Cash balance at the beginning of April is Rs.10,000.
- All products are sold immediately they have been made and that materials used and sums spent on wages and expenses during any particular month relate strictly to the sales made during that month.
Prepare cash flow forecast month by month from April to July, profit and loss forecast for four months (April – July) and a movement of funds statement for the four months period (April-July).

- (b) What are the matters to be considered in the context of working capital management in public sector undertaking?

(14+6=20 Marks)

Question 5

Write short notes on:

- (a) Bridge Finance.
- (b) Call and put option with reference to debentures.
- (c) Capital Asset Pricing Model (CAPM).
- (d) Forward as hedge instrument.

(4×5=20 Marks)