

# Managing Finances

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION  
ADVANCED LEVEL

WEDNESDAY 15 DECEMBER 2004

## QUESTION PAPER

Time allowed **3 hours**

ALL FOUR questions are compulsory and MUST be answered

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

The Association of Chartered Certified Accountants

# Paper T10



**ALL FOUR questions are compulsory and MUST be attempted**

- 1** Tots Ltd specialises in the importation and sale of equipment for children's indoor play centres. The company was set up two years ago by its joint shareholders, Mr and Mrs Brute.

The business has been very successful, expanding rapidly over the last year, and the cash balance in the company's current account has exceeded £1 million on several occasions recently.

Mr and Mrs Brute have asked you, an accounting technician for Tots Ltd, to assist them in managing their cash balances over the next six months.

You have been provided with the following information.

- (i) The bank balance on 1 January 2005 is forecast at £1.2 million in credit.
- (ii) Sales for November and December 2004 are £1.3 million per month. They are expected to rise to £1.5 million in January 2005, £1.7 million in February and £1.9 million in March. They will then fall to £1.4 million for each of the following six months. This is due to a downturn in demand as the weather improves.
- (iii) All sales are made on credit. 2% of debtors do not pay at all, 70% pay one month after sale and the remaining 28% pay two months after sale.
- (iv) Purchases are made one month prior to sales, and two months' credit is taken from suppliers.
- (v) The company's gross profit margin is 50%.
- (vi) The cost of employing Tots Ltd's permanent staff is £150,000 per month. Tots Ltd also employs temporary staff during January, February and March at an additional cost equating to 3% of sales each month.
- (vii) Tots Ltd uses a courier to despatch the equipment to its customers. The cost of this service is 2% of sales value in January to March, falling to 1% thereafter.
- (viii) Administration costs are forecast at £30,000 for January. These costs are directly proportional to sales each month.
- (ix) Mr and Mrs Brute will be attending a conference abroad in July 2005 at a total cost of £5,000. They must complete the booking form and send it off, along with a deposit of £2,000, by the end of January 2005. The final balance is due in June.
- (x) The company charges depreciation of £45,000 each month.
- (xi) Tots Ltd also owns two indoor play centres that it rents out at the rate of £3,500 each per month from January to April, falling to £3,000 per month thereafter. All rents are received one month in advance.
- (xii) The company will invest in a new computer system later in the year. This will be paid for by two equal instalments of £200,000, one in June and one in September.

**Required:**

- (a) Prepare a monthly cash budget for EACH of the six months to 30 June 2005, showing clearly any necessary workings.**

**NOTE: All workings should be in £000.**

**Unless told otherwise, assume that payments are made in the month in which the costs are incurred.**

(16 marks)

Mr and Mrs Brute are aware that the business is holding too much cash, but are unsure how to invest it safely. They are very risk averse, having each lost a considerable amount of money on the Stock Exchange. They also want to ensure that they retain enough cash to allow the business to meet its debts as they fall due.

- (b) Briefly explain three motives for holding cash, as identified by Keynes.**

(6 marks)

(c) Define and explain the characteristics of **THREE** out of the four types of investment below. In light of the characteristics you have identified, conclude as to whether you consider each of the investments you have explained to be an appropriate use of Tots Ltd's cash surplus.

- (i) Certificates of deposit;
- (ii) Gilt-edged securities (gilts);
- (iii) Shares;
- (iv) Bills of exchange.

(18 marks)

Note: Each type of investment carries equal marks.

(40 marks)

2 Pooch Ltd makes and sells pet care products. The following projected data for the next year is available.

Sales	£2,200,000
Costs as percentage of sales	
Raw materials	15%
Direct labour	20%
Variable production overheads	11%
Fixed production overheads	10%
Other costs	12%
Working capital statistics	
Average raw material holding period	4 weeks
Average Work-in-progress (WIP) holding period	2 weeks
Average finished goods holding period	4 weeks
Average debtors' collection period	6 weeks
Average creditors' payment period on:	
Raw materials	4 weeks
Direct labour	1 week
Variable production overheads	8 weeks
Fixed production overheads	5 weeks
Other costs	12 weeks

Other relevant information

- All finished goods stock and WIP values include raw materials, direct labour, variable production overheads and apportioned fixed production overhead costs.
- Assume WIP is 75% complete as to materials and 50% complete as to direct labour, variable production overheads and fixed production overheads.
- Assume there are 52 weeks in one year.
- Assume that production and sales volumes are the same.

**Required:**

**(a) Calculate the estimated average working capital required by Pooch Ltd for the year, showing clearly all necessary workings.**

**NOTE: All workings should be in £.**

(14 marks)

**(b)** Pooch Ltd is currently in dispute with one of its suppliers, Petcoats Ltd. Pooch Ltd is unsure of its legal obligations regarding an agreement it made with Petcoats Ltd. The Financial Director of Pooch Ltd has asked you, an accounting technician, to explain certain legal terms to him.

**Define and briefly explain the following legal terms:**

- (i) 'Offer';** (2 marks)
- (ii) 'Acceptance';** (2 marks)
- (iii) 'Consideration'.** (2 marks)

**(20 marks)**

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Question 3 begins on page 6**

**3** Taxi Ltd is a long established company providing high quality transport for customers. It currently owns and runs 350 cars and has a turnover of £10 million per annum.

The current system for allocating jobs to drivers is very inefficient. Taxi Ltd is considering the implementation of a new computerised tracking system called 'Kwictrac'. This will make the allocation of jobs far more efficient.

You are an accounting technician for an accounting firm advising Taxi Ltd. You have been asked to perform some calculations to help Taxi Ltd decide whether Kwictrac should be implemented. The project is being appraised over five years.

The costs and benefits of the new system are set out below.

- (i) The central tracking system costs £2,100,000 to implement. This amount will be payable in three equal instalments: one immediately, the second in one year's time, and the third in two years' time.
- (ii) Depreciation on the new system will be provided at £420,000 per annum.
- (iii) Staff will need to be trained how to use the new system. This will cost Taxi Ltd £425,000 in the first year.
- (iv) If Kwictrac is implemented, revenues will rise to an estimated £11 million this year, thereafter increasing by 5% per annum (i.e. compounded). Even if Kwictrac is not implemented, revenues will increase by an estimated £200,000 per annum, from their current level of £10 million per annum.
- (v) Despite increased revenues, Kwictrac will still make overall savings in terms of vehicle running costs. These cost savings are estimated at 1% of the post Kwictrac revenues each year (i.e. the £11 million revenue, rising by 5% thereafter, as referred to in note (iv)).
- (vi) Six new staff operatives will be recruited to manage the Kwictrac system. Their wages will cost the company £120,000 per annum in the first year, £200,000 in the second year, thereafter increasing by 5% per annum (i.e. compounded).
- (vii) Taxi Ltd will have to take out a maintenance contract for the Kwictrac system. This will cost £75,000 per annum.
- (viii) Interest on money borrowed to finance the project will cost £150,000 per annum.
- (ix) Taxi Ltd's cost of capital is 10% per annum.

**Required:**

- (a) Calculate the net present value of the new Kwictrac project to the nearest £000. Use the discount factors provided at the end of the question.** (10 marks)
- (b) Calculate the simple payback period for the project and interpret the result.** (3 marks)
- (c) Calculate the discounted payback period for the project and interpret the result.** (3 marks)

- (d) Taxi Ltd wants to ensure that it has enough cash available to pay the second and third instalments for the Kwictrac system, when they fall due. The company has therefore decided to invest the cash on time deposits with its local bank. The rates of interest paid by the bank are as follows:

6 month deposits	7% per annum
One year deposits	8% per annum
Two year deposits	9% per annum
Three year deposits	10% per annum

Interest is paid once a year, at the end of the year.

**Calculate the total amount of cash that Taxi Ltd needs to put on deposit immediately in order to meet the final two instalments for Kwictrac.** (4 marks)

**NOTE: You should assume that all cash flows occur at the end of the year, unless otherwise stated.**

Present Value table (extract)

Periods (n)	Discount rate (r)
	10%
1	0.909
2	0.826
3	0.751
4	0.683
5	0.621

**(20 marks)**

- 4 Skint Ltd is a small family owned company that makes fuses for electrical plugs. It was set up twenty-five years ago by its main shareholder, Mr Holmes, who is also the Managing Director of the company.

The company is facing short-term cash flow difficulties. It is already a highly geared company and Mr Holmes is concerned that the bank will not lend it any more money. He is considering applying for a personal loan or giving a personal guarantee in order to solve the company's short-term cash flow difficulties.

**Required:**

- (a) **List and explain the general factors that will be taken into account by a bank when deciding whether or not to lend money to a client.** (14 marks)
- (b) **Briefly explain three characteristics that any security for a loan should have.** (3 marks)
- (c) **Briefly describe the following:**
- (i) **bullet repayment loan;**
  - (ii) **balloon repayment loan;**
  - (iii) **amortising loan (straight repayment loan).** (3 marks)

**(20 marks)**

**End of Question Paper**