Managing Finances

Paper T10

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION

ADVANCED LEVEL

WEDNESDAY 14 DECEMBER 2005

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

ALL FOUR questions are compulsory and MUST be attempted

1 Gold Club Ltd is a newly established company that has not yet commenced trading. The two shareholders/directors are planning to set up an Internet business. With the help of finance from venture capitalists, they plan to set up a website through which individuals can join a 'Gold Club'. Membership of the club will provide members with a range of quality travel services including access to a First Class lounge at airports, travel insurance for an unlimited number of trips and discounted upgrades for seats on flights. It will take one year to set up the business.

You are an accounting technician who has been asked to appraise the investment of capital in the project based on a six-year plan (one year to set up the business followed by five years of operation).

(i) Market research has been carried out at a cost of £200,000. This indicates that the number of new members joining the club would be approximately 5,000 each year. Of these new joiners each year, 50% will renew their membership ONCE, in the following year.

(ii) Membership fees for new members joining the club each year will be £500. Members renewing their membership in the subsequent year will benefit from a reduced annual fee of £400.

(iii) The costs of setting up the website are as follows:
– Design costs: £1,220,000
– Administrative costs: £125,000
– Legal advice fees: £155,000

25% of these costs will be paid immediately as a deposit, with the remainder being paid in one year's time.

(iv) The costs of the technical support for maintaining the website will be £100,000 for the first year it is in operation. These costs will increase by 20% year-on-year thereafter.

(v) All new members will be issued with a club card, with an electronic chip in it. The cost of this card for Gold Club Ltd will be £3 per member. Once the original card is issued, there will be no need to issue a further card for renewal of membership. The supplier will be paid annually in arrears for all cards issued in that year. The first payment is therefore due at the end of the second year.

(vi) For every member who uses a First Class lounge at any airport worldwide, a charge of £20 will be made to Gold Club Ltd each time the lounge is used. It is estimated that 40% of members will use it three times a year, 30% of members will use it twice a year, 20% will use it once a year and 10% will not use it at all.

(vii) Gold Club Ltd will purchase a travel insurance policy based primarily on the number of members in the scheme. It is assumed that all members will make use of the travel insurance and the supplier will therefore charge Gold Club Ltd £50 per member in the first year, increasing steadily by £2 per member each year after that. Each member will have to e-mail the travel insurers with details of their trip in advance of each trip. Therefore, the insurers will also charge Gold Club Ltd an administrative fee of £2 for every e-mail received. Gold Club Ltd estimates that on average each member will send two e-mails per annum.

(viii) Gold Club Ltd will pay ten major airlines £100,000 EACH per annum in order to provide their members with access to discounted seat upgrades.

(ix) Overdraft interest will be £5,000 per annum.

(x) Assume that all cash flows, including the receipt of membership fees, occur at the end of each year, unless otherwise stated.

(xi) The company's cost of capital is 10% per annum.

(xii) Workings should be in £'000, to the nearest £'000.

Required:

(a) **Using the discount tables provided at the end of the question, calculate the project's net present value (NPV) at the company's cost of capital. Conclude as to whether the company should proceed with the project, giving a reason for your conclusion.** (30 marks)

(b) **Identify and discuss five factors that a venture capital organisation would take into account when deciding whether or not to invest in Gold Club Ltd.** (10 marks)

Present value table (extract)

Periods (n)	**Discount rates (r)**	
	10%	20%
1	0·909	0·833
2	0·826	0·694
3	0·751	0·579
4	0·683	0·482
5	0·621	0·402
6	0·564	0·335
7	0·513	0·279
8	0·467	0·233
9	0·424	0·194
10	0·386	0·162

(40 marks)

2 Cleanly Ltd is a manufacturing company producing and selling a range of cleaning products to wholesale customers. It has three suppliers and two customers. Cleanly Ltd relies on its cleared funds forecast to manage its cash.

You are an accounting technician for the company and have been asked to prepare a cleared funds forecast for the period Monday 2 January to Friday 6 January 2006 inclusive. You have been provided with the following information:

(1) Receipts from customers

Customer name	Credit terms	Payment method	2 Jan 2006 sales	2 Dec 2005 sales
W Ltd	1 calendar month	BACS	£150,000	£130,000
X Ltd	None	Cheque	£180,000	£160,000

(a) Receipt of money by BACS is instantaneous.

(b) X Ltd's cheque will be paid into Cleanly Ltd's bank account on the same day as the sale is made and will clear on the third day following this (excluding day of payment).

(2) Payments to suppliers

Supplier name	Credit terms	Payment method	2 Jan 2006 purchases	2 Dec 2005 purchases	2 Nov 2005 purchases
A Ltd	1 calendar month	Standing order	£65,000	£55,000	£45,000
B Ltd	2 calendar months	Cheque	£85,000	£80,000	£75,000
C Ltd	None	Cheque	£95,000	£90,000	£85,000

(a) Cleanly Ltd has set up a standing order for £45,000 a month to pay for supplies from A Ltd. This will leave Cleanly's bank account on 2 January. Every few months, an adjustment is made to reflect the actual cost of supplies purchased **(you do NOT need to make this adjustment)**.

(b) Cleanly Ltd will send out, by post, cheques to B Ltd and C Ltd on 2 January. The amounts will leave its bank account on the second day following this (excluding the day of posting).

(3) Wages and salaries

	December 2005	January 2006
Weekly wages	£12,000	£13,000
Monthly salaries	£56,000	£59,000

(a) Factory workers are paid cash wages (weekly). They will be paid one week's wages, on 6 January, for the last week's work done in December (i.e. they work a week in hand).

(b) All the office workers are paid salaries (monthly) by BACS. Salaries for December will be paid on 2 January.

(4) Other miscellaneous payments

(a) Every Monday morning, the petty cashier withdraws £200 from the company bank account for the petty cash tin. The money leaves Cleanly's bank account straight away.

(b) The window cleaner is paid £30 from petty cash every Wednesday morning.

(c) Office stationery will be ordered by telephone on Tuesday 3 January to the value of £300. This is paid for by company debit card. Such payments are generally seen to leave the company account on the next working day.

(d) Five new computers will be ordered over the Internet on 5 January at a total cost of £6,500. A cheque will be sent out on the same day. The amount will leave Cleanly Ltd's bank account on the second day following this (excluding the day of posting).

(5) Other information

The balance on Cleanly's bank account will be £200,000 on 2 January 2006. This represents both the book balance and the cleared funds.

Required:

Prepare a cleared funds forecast for the period Monday 2 January to Friday 6 January 2006 inclusive using the information provided. Show clearly the uncleared funds float each day.

(20 marks)

3 Fibre Clean Ltd is a small company specialising in the cleaning of upholstery and carpets. All of the company's current customers are domestic and pay at the time the work is done. Mr Sykes, the owner, is considering undertaking a number of commercial contracts instead of his domestic work because the profit margins are much higher. It is standard practice in this sector to offer 30-day credit terms to customers. Mr Sykes is concerned about a number of issues. Firstly, how he can ensure that he only provides credit to creditworthy customers. Secondly, how he will manage the extra administrative workload and, finally, what the effect of providing credit will be on his cash position. He is already overdrawn at his local bank.

A friend of Mr Sykes has suggested that he should obtain 'trade references' for his new customers and seek the advice of a 'credit reference agency'.

Required:

(a) Describe the following sources of externally generated information and their usefulness in assessing the creditworthiness of Mr Sykes' new customers:

(i) Trade reference;
(ii) Credit reference agency. (6 marks)

(b) Explain the meaning of 'debt factoring' and 'invoice discounting' to Mr Sykes. Highlight any key differences between the two and suggest which one may be more useful for Mr Sykes. (5 marks)

(c) If Mr Sykes changes to commercial contracts, he expects sales for the next year to be £75,000, with customers paying within the 30-day limit set. It would cost him £2,000 per annum to employ someone one day a week to invoice customers and collect debts for him. Alternatively, his local bank has offered to provide a factoring service for him, including the advance of 80% of his sales invoices. They would charge 2% of turnover for the administration and charge interest of 8% per annum on advances. However, the bank would not invoice Mr Sykes' customers. He would need to employ somebody for half a day a week to do this, at a cost of £1,000 per annum.

Mr Sykes pays interest at the rate of 10% per annum on his overdrawn bank account.

Mr Sykes thinks that customers will pay within 30 days regardless of which option is selected.

Required:

Calculate and recommend whether or not Mr Sykes should factor his debts. (9 marks)

(20 marks)

4 **(a)** **Define the term 'financial intermediary', distinguishing between a 'broker' and a 'principal'. Give four examples of organisations that act as financial intermediaries.** (4 marks)

(b) **Discuss four main benefits of financial intermediation.** (8 marks)

(c) **Briefly describe four main money market instruments.** (4 marks)

(d) Governments use monetary policy to control prices, economic growth and employment levels.

Required:

Define 'quantitative' and 'qualitative' controls used by governments. (4 marks)

(20 marks)

End of Question Paper