Managing Finances

Paper T10

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION

ADVANCED LEVEL

WEDNESDAY 15 JUNE 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

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1 Seventeen Ltd

Sally Sharp is the Managing Director of Seventeen Ltd, a production company responsible for the huge success of the television programme 'Pop Icon 1' and 'Pop Icon 2.' The programme is just nearing the end of the second series, with only four weeks to go before the public chooses a winner.

Sally is in the process of deciding whether to run a 'Pop Icon' tour. This would consist of twelve live performances, in twelve different locations, during the month of September. The twelve finalists from the television programme would all take part in the tour. Seventeen Ltd ran a 'Pop Icon 1' tour after the first series and this was a big success. Sally is concerned, however, about the effect of the tour on the company's cash flow, as the company currently has funds tied up in several other projects.

You have been provided with the following information:

(i) Seventeen Ltd will open a separate bank account on 1 July 2005 for the tour, with an opening balance of £500,000.

(ii) During the Pop Icon 1 tour, it was calculated that for each thousand votes cast during the final twelve television programmes, one person attended the Pop Icon tour. This ratio is expected to remain the same for the second Pop Icon tour, should it go ahead.

During the last eight weeks of Pop Icon 2, the public has cast a total of 180 million votes. This is an average of 22·5 million votes per week. Public interest is expected to increase over the final four weeks and it is therefore estimated that votes for the remaining four weeks will be 100 million in total.

(iii) Tickets vary in price according to the seat location within each venue. Ticket information is as follows:

Ticket type	Price	Percentage of total tickets sold
Premium seats	£35	10%
Arena floor	£30	30%
Stalls	£25	60%

It is expected that 20% of ticket revenues will be received in September, 30% in October, 30% in November and the remainder in December.

(iv) At every live performance, a selection of souvenirs will be on sale, from mugs and t-shirts to CDs and DVDs. From the Pop Icon 1 tour it has been calculated that for every ticket sold, an average of £6 is spent on souvenirs. These monies are received by Seventeen Ltd in September.

(v) The souvenirs are purchased from two key suppliers – Records Ltd, who produce all the CDs and DVDs (50% of total souvenirs sales), and Junk Ltd who produce everything else (remaining 50% of sales). The gross profit margins for Seventeen Ltd are 25% for CDs and DVDs and 50% for everything else. All orders must be made from both suppliers in August but whereas Records Ltd requires payment at the time of order, Junk Ltd provides one month's credit.

(vi) Each of the twelve performers will be paid £35,000 for his/her participation in the live tour. Of this amount, £5,000 will be paid at the start of the tour at the beginning of September, with the remainder being paid at the beginning of October.

(vii) Seventeen Ltd will pay an average of £150,000 to hire each of the twelve venues for the live tour. In order to secure the venues, a deposit of 10% had to be paid in May for each venue out of one of the company's existing bank accounts. The remaining balances will be paid in August from the Tour bank account.

(viii) Seventeen Ltd will need to hire two tour buses in September – one for the performers and one for the crew. The cost of these will be £10,000 each. In addition to these, six heavy vehicles will be required to transport equipment. Each vehicle costs £12,000. All of these transport costs include driver costs and fuel. 75% of the total transport costs (including buses) will be paid in September, with the remainder being paid in October.

(ix) For each performer on the tour, five members of crew are required over and above the already existing staff of Seventeen Ltd. The average gross wage of each crewmember is £12,000 per month. Whilst all of these crewmembers are required for the month of September, only half of them are needed for August. All crewmembers are paid at the end of each month that they work.

(x) The crewmembers are hired through an agency, Hands on Deck Ltd. The agency charges a fee for each member of crew hired through them. The fee is calculated as 10% of the gross monthly wage of each crewmember and is paid for EVERY month that they work. Hands on Deck Ltd allows one month's credit.

(xi) Publicity for the tour is expected to cost a further £2·5 million. Of this amount, 20% will be paid in July and 30% paid in August. Sally has negotiated delaying the remaining payment until November.

(xii) Other costs are estimated to be in the region of £240,000 IN TOTAL, incurred evenly through the months of July, August, September and October. They will be paid in the month in which they are incurred.

(xiii) All workings should be in £'000, to the nearest £'000.

Required:

(a) Prepare a monthly cash budget for the Pop Icon 2 Tour for EACH of the six months to 31 December 2005, showing clearly any necessary workings. (30 marks)

The following information applies to part (b) only.
Sally is concerned that the above calculations rely on the public's average weekly votes increasing in the final four weeks of the programme. They also rely on the assumption that there will be one ticket sale per thousand votes. Sally is concerned about the effect on profit should these assumptions be wrong, with the second tour proving to be less popular that the first one. She now wants you to assume that voting for the final four weeks of the programme stays at the same average level as the previous eight weeks AND that for every TWO thousand votes only one person attends the tour.

(b) Calculate the original profit of the project as per part (a) AND the revised profit/loss after the change in the assumptions. (10 marks)

(40 marks)

2 Silly Filly Ltd

Silly Filly Ltd is a recently established company specialising in the manufacture of talking toy horses for children. The Silly Filly range currently comprises three key products – all of which are toy horses – plus approximately thirty accessories to complement the range, from stables to grooming kits.

The Silly Filly range has been such a success in the last year that the management is considering producing an animated film to accompany the range. This is in accordance with the company's long-term expansion plans, culminating in a stock exchange flotation in three year's time.

The film will take one year to make. In the year following that, sales of the film will commence.

You, an accounting technician for the company, have been asked to assist in appraising the project to decide whether it should go ahead. The following information is relevant to your calculations.

(i) Market research has already been carried out at a cost of £1·2 million.

(ii) The services of a company specialising in animation will be required at a total cost of £520,000. 50% of these costs will be paid immediately with the remainder being paid in one year's time.

(iii) Two producers will be employed throughout the first year of the project. They will each be paid salaries of £120,000.

(iv) Other production costs during the year are expected to be £650,000.

(v) A film director will be employed immediately on a one-year contract at a cost of £160,000.

(vi) The animated film is expected to generate revenues of £1·2 million in the first year of sales, £2·2 million in the second year, and £1·6 million in the third year.

(vii) The two producers and the director will each be paid royalties from the film. These will be paid at the rate of 1·5% of gross revenues for EACH of the producers and 2% for the director. They will always be payable one year in arrears.

(viii) Specialist equipment will need to be purchased immediately for the film production. This will cost £2·3 million but can be sold at the end of the year for £1·7 million.

(ix) A loan for £1 million will be taken out to assist in financing the project. The loan will be repayable in two year's time, with interest of 8% per annum being payable for its duration.

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

(xi) Assume that all cash flows occur at the end of each year, unless otherwise stated.

Required:

(a) Using the present value 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. (10 marks)

(b) List four costs associated with a new equity issue. (4 marks)

(c) Explain three reasons why a company may seek a stock exchange listing. (6 marks)

Present Value table (extract)

Periods (n)	Discount rate (r) 10%	Discount rate (r) 8%
1	0·909	0·926
2	0·826	0·857
3	0·751	0·794
4	0·683	0·735
5	0·621	0·681

(20 marks)

3 Duel Fuel Ltd

Duel Fuel is an energy company that buys gas in bulk and sells it to the main market providers in the UK. The company's credit control department is poorly run at present, following the resignation six months ago of the credit controller. Poor credit control has had a serious effect on the company's overdraft, which currently stands at £5 million, compared to £3 million at the same time last year. This, in turn, is pushing up interest costs.

The company is therefore considering factoring its debts to improve its cash flow and reduce costs.

Credit sales for the last year totalled £8·5 million, with average debtors of £4·3 million. Next year, sales are expected to be 20% higher, and debtor days are expected to remain the same if the factoring arrangement is NOT entered into.

A factoring company has put forward the following proposal to Duel Fuel Ltd:

(i) The factor would immediately advance 70% of the value of sales invoices.
(ii) The factor will charge interest of 12% per annum on the advances.
(iii) The factor will charge an administration fee of 1·5% of turnover for the service.
(iv) Debtor days will be reduced to 60 days, the industry norm, as a result of stricter credit control procedures

Should Duel Fuel Ltd enter into the agreement, it will make both of the credit control staff redundant. They earn salaries of £14,000 per annum each, but they will both be paid a redundancy package of £3,000 each.

Current bank overdraft rates are 9% per annum.

Required:

(a) Calculate for the coming year whether it is financially viable for Duel Fuel Ltd to factor its debts. (10 marks)

(b) Identify five advantages of factoring. (5 marks)

(c) List five functions that a credit control department may undertake. (5 marks)

(20 marks)

4 **Gym Jam Ltd**

Gym Jam Ltd is a well-established company that hires out a range of top quality treadmills to gyms across the country, under operating leases.

Over recent months, Gym Jam Ltd's client base has expanded so rapidly that the company has struggled to finance the level of treadmill purchases required to supply its new clients. The company used a loan from its local bank to assist with its last bulk order of treadmill purchases two years ago. Interest on this loan was variable, being linked to the bank's base rate, and Gym Jam Ltd saw its interest charges steadily increasing over the two-year period. It is now considering using finance leases (fixed interest) to acquire the next bulk order of treadmills.

In the last year, the company's debtor days have increased from an average of 30 days to 45 days, partly because sales ledger staff could not cope with the increased workload. Currently, all customers are invoiced every three months (quarterly) for the hire of the treadmills, and most of them pay by cheque. Invoices are raised manually and state on them that payment terms are 30 days from invoice date.

You are an accounting technician for the company, and have been asked to assist in resolving these problems.

Required:

(a) Briefly describe three key characteristics of an operating lease. (3 marks)

(b) Briefly describe five key characteristics of a finance lease. (5 marks)

(c) Identify four weaknesses in Gym Jam Ltd's invoicing and credit control system and indicate how they can be rectified. (4 marks)

(d) List the factors that affect the rate of interest for a loan. (6 marks)

(e) Explain why the interest charges on Gym Jam Ltd's loan kept increasing. (2 marks)

(20 marks)

End of Question Paper