Managing Finances

Paper T10

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION

ADVANCED LEVEL

WEDNESDAY 13 JUNE 2007

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 Go Green Ltd is a small company specialising in the manufacture of a small range of environmentally friendly toiletries and cleaning products. It is considering extending its production lines to include environmentally friendly soap and washing-up liquid.

The company's research and development department has already spent £450,000 developing the products and a further £325,000 on test marketing them. If the company decides to proceed with the project, new machinery will be purchased immediately and production will commence straight away.

Notes

1. Forecast sales in '000 units, are as follows:

	Years				
	1	2	3	4	5
Soap	250	200	150	90	30
Washing up liquid	240	280	320	170	50

2. Forecasts for the revenues and costs per unit for each of the new products have been made, as detailed below. However, these may need to be revised as per notes (a) to (c) below.

	Soap	Washing-up liquid
	£	£
Selling price	1·75	1·60
Direct materials	(0·15)	(0·35)
Direct labour (note a)	(0·25)	(0·12)
Variable overheads (note b)	(0·50)	(0·24)
Allocated fixed overheads (note c)	(0·65)	(0·65)
Profit	£0·20	£0·24

(a) The product cost cards for both products above have been prepared on the basis that each factory worker is paid a standard hourly rate of £6. Further details of labour requirements are as follows:

Year one

Production of each unit of soap requires 2·5 minutes of one factory worker's time. However, all workers are currently working to full capacity. Therefore, for the first year's production of soap, they will have to work overtime, for which they are paid £7·20 per hour.

Production of each unit of washing-up liquid requires 1·2 minutes of one factory worker's time. During the first year, temporary workers provided by an agency will be used to produce the washing-up liquid at a cost to the company of £7 per hour.

Years two to five

New permanent staff will be recruited to produce both soap and washing-up liquid. They will be paid at the company's standard hourly rate of £6 per hour.

(b) Variable overheads represent factory power costs, which vary according to labour hours worked.

(c) Allocated fixed overheads comprise factory rental costs of £0·10 per unit and depreciation of £0·55 per unit.

3. The company will need to purchase a new piece of machinery immediately costing £500,000 if the project is to proceed. Some modifications will need to be made to the machinery on site. They will take place as soon as the machinery is purchased and will take two days to complete. The cost of these will be £150,000, payable on completion. The machinery will have no scrap value at the end of the project.

4. There are currently two production lines that are not in use on the top floor of the factory. If the project goes ahead, these two lines will be used for production. If the project does not go ahead the top floor will be rented out immediately to a third party, producing income of £125,000 per annum, receivable annually in arrears.

5. Go Green Ltd's cost of capital is 10% per annum.

6. Assume that all cash flows occur at the end of the year unless otherwise stated.

7. All workings should be in £’000 to the nearest £’000.

Required:

(a) Using the discount factors provided, calculate the net present value of the proposed project over five years and conclude whether the project should be accepted. (20 marks)

(b) Calculate the internal rate of return of the project using the tables provided. (5 marks)

(c) Calculate the discounted payback period for the project at the company’s cost of capital. If the company only accepted projects with a discounted payback period of three years or less, decide whether the company should accept this project. (4 marks)

The company has now decided that the project should be funded using debt finance, but it is unsure which form of debt finance would be best.

Required:

(d) Discuss three factors that any business should consider when deciding whether a loan or an overdraft is the best way to finance a project. (6 marks)

(e) Recommend and briefly explain whether an overdraft or a loan would be the most appropriate form of finance for Go Green Ltd. (3 marks)

(f) What is the UK government’s ‘Loan Guarantee Scheme’ and how might it help Go Green Ltd, if required? (2 marks)

Extracts from discount factor tables

Time	Factor 10%	Factor 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

(40 marks)

2 Camp Ltd is a retailer of real wood flooring. It buys and sells 20,000 packs of flooring each year from its supplier, Strong Ltd.

The real wood flooring from Strong Ltd costs £35 per pack. There is an order processing charge of £150 per order, irrespective of the quantity of packs ordered, and Strong Ltd takes 10 days to deliver the wood flooring. The average cost of holding one pack of real wood flooring for one year is £9.

A new supplier of real wood flooring, Fake Ltd, has offered Camp Ltd wood flooring on slightly different terms. Fake Ltd guarantees that its wood will never arrive damaged since it uses special packaging designed for maximum protection. It charges £34·95 per pack for the flooring. There is an order processing charge of £160 per order, irrespective of the quantity of packs ordered, and Fake Ltd takes 7 days to deliver the goods. The average cost of holding one pack of Fake Ltd's real wood flooring for one year is £12. This is because the special packaging takes up additional storage space.

The economic order quantity, which will minimise costs, is:

$$EOQ = \sqrt{\frac{2CoD}{Ch}}$$

Where Co = the cost of placing one order
D = the annual demand in units
Ch = the cost of holding one unit per annum.

Required:

(a) Under the current arrangement, calculate:

(i) the economic order quantity for packs of wood flooring;
(ii) the total cost (ordering, purchase and holding cost) of stocking wood flooring for one year. (5 marks)

(b) For the new supplier calculate:

(i) the economic order quantity for packs of wood flooring;
(ii) the total cost (ordering, purchase and holding cost) of stocking wood flooring for one year (5 marks)

Camp Ltd has decided that it is NOT going to change suppliers. It, therefore, contacts Fake Ltd and informs them that it does not wish to change suppliers. Fake Ltd has now offered Camp Ltd a bulk purchase discount of 1% on all single orders for 2,000 or more packs of wood.

Required:

(c) Calculate and conclude whether it is worth accepting the offer by ordering 2,000 packs at a time from Fake Ltd. (4 marks)

(d) Outline three non-financial factors that should be taken into account when deciding whether to change suppliers from Strong Ltd to Fake Ltd. (6 marks)

(20 marks)

3 Porkys Ltd is an ice cream manufacturing company preparing its accounts to 31 May each year. The company's peak season occurs in the months of July, August and September and it always prepares a profit forecast for this period.

The following cash budget has been prepared for the six months ending 30 November 2007.

	Jun £'000	Jul £'000	Aug £'000	Sep £'000	Oct £'000	Nov £'000
Receipts from sales	1,100	1,250	1,400	1,800	2,200	1,700
Sale of machinery	–	45	–	–	–	–
Total receipts	1,100	1,295	1,400	1,800	2,200	1,700
Payments						
Ingredients	250	280	360	440	340	340
Labour	350	450	550	425	275	250
Sundry expenses	75	85	95	80	70	65
Purchase of machinery	–	–	120	–	60	–
Loan repayments	50	–	50	–	50	–
Total payments	725	815	1,175	945	795	655
Receipts less payments	375	480	225	855	1,405	1,045
Opening cash balance b/f	1,400	1,775	2,255	2,480	3,385	4,790
Interest received	–	–	–	50	–	–
Closing cash balance c/f	1,775	2,255	2,480	3,385	4,790	5,835

Notes/assumptions made when preparing the cash flow forecast

1 Customers always take two month's credit.
2 The machinery to be sold for £45,000 will give rise to a profit on disposal of £3,000.
3 Depreciation of £13,000 will accrue during the three months ending 30 September 2007.
4 One month's credit is always taken from suppliers of ingredients.
5 There are no stocks of raw materials or finished goods maintained.
6 Labour is paid by BACS on the last day of each month, for that month's work.
7 Sundry expenses are all paid in the month in which they are incurred.
8 The loan repayment relates to an interest free loan obtained from Porkys Ltd's parent company.
9 Interest is received by Porkys Ltd from the bank twice a year. The interest receivable for the peak season of July, August and September is expected to be £30,000.
10 All workings should be in £'000s to the nearest £'000.

Required:

(a) Prepare a profit forecast for the three months ending 30 September 2007. Show all workings clearly. Where any items have been excluded from the profit forecast, include a note to justify your treatment of the item. (10 marks)

Porkys Ltd's parent company is considering centralising the treasury function for the whole group.

(b) List four roles of a treasury department. (4 marks)

(c) Describe three advantages of having a centralised treasury department. (6 marks)

(20 marks)

4 Jay Ltd manufactures furniture. It has come under pressure in recent years to reduce prices in order to compete with some larger competitors in the market. The company's aim has therefore been to maintain sales levels, with the effect that debtor control has been allowed to deteriorate. The company has always had a target of keeping the debtors period at an average of 45 days.

Debtors as at 31 May 2007 are £323,654. Sales for the year ending 31 May 2007 were £1,581,743. This figure included £14,250 of cash sales. During this time, debts of £26,784 were written off. All £26,784 relates to sales made in the year ending 31 May 2007.

Required:

(a) Calculate the current debtors collection period, in days, from the above information. (3 marks)

(b) How much of the year-end debtors' balance would have to be immediately recovered in order to reduce the debt collection period to the target level? (2 marks)

(c) Calculate the company's bad debt ratio for the year ended 31 May 2007. (2 marks)

(d) List five procedures that could be used to pursue the overdue debts. (5 marks)

Jay Ltd has carried out some of the procedures to collect debts. One of its major debtors is still refusing to pay on the basis that it was not satisfied with the quality of some of the goods it received and had to make refunds to its own customers. Jay Ltd does not want to sue the customer but has heard of 'arbitration'.

(e) Explain what arbitration is, in this context. (2 marks)

(f) State two advantages and two disadvantages of using arbitration as opposed to taking a case to court. (4 marks)

You have now learnt that arbitration will not be possible since your client informs you that it is actually insolvent. You have heard that creditors can attempt to recover monies owing to them through 'liquidation'.

(g) Briefly explain what happens when a company goes into liquidation. (2 marks)

(20 marks)

End of Question Paper