

THE OPEN UNIVERSITY OF SRI LANKA
COMMONWEALTH EXECUTIVE MASTER OF BUSINESS/PUBLIC
ADMINISTRATION
FINAL EXAMINATION – MARCH 2006
MCP 1609 – ACCOUNTING AND FINANCE FOR MANAGERS
DURATION : THREE (03) HOURS



Date : 22nd April 2006

Time: 1.30 p.m. 4.30 p.m.

Answer Six (6) Questions in all, selecting One (1) Question from Each Part, (PARTS A-F).
 Non-programmable calculators are allowed.
 Any assumptions should be clearly stated
 Graph paper and PV Tables will be provided.

PART A

1. "Every business needs to recognize the importance of Finance function". Discuss.
 (15 Marks)
2. Define the term " financial system." and discuss its significance in the modern economy.
 (15 Marks)

PART B

3. Write short notes on any four (4) of the following

(a) Money Market	(e) Control Ratios
(b) Time Value of Money	(f) JIT purchases
(c) Working Capital Policy	(g) Appropriation Decision
(d) Flexible Budget	(h) Average Collection Period

 (16 Marks)
4. Compare and Contrast any four (4) of the following

(a) Direct Cost vs Indirect Cost	
(b) Public Offering vs Private Placement	
(c) Straight Line Method of Depreciation vs Written Down Value Method of Depreciation	
(d) Controllership vs Treasurership	
(e) Profit Maximization objective vs Wealth Maximization objective	
(f) Material Price Variance Vs Material Usage Variance	
(g) Permanent vs Temporary Working Capital	

 (16 Marks)

PART C

5. Critically evaluate any five (5) of the following statements

- (a) "When interest rates are expected to rise, the yield curve is upward sloping."
 - (b) "The key factor in valuation of any financial instrument is its expected return."
 - (c) "Lower the stocks, lower the holding costs and higher the profits."
 - (d) "The use of electronic banking techniques can result in greater economisation of money transactions."
 - (e) "Treasury bonds are money market instruments issued for a duration of less than one year."
 - (f) "Bad debt loss is a function of sales amount."
 - (g) "In project evaluation IRR is superior to NPV method."
 - (h) "The higher the debt-equity ratio, the larger the shareholders' earnings."
- (15 Marks)

PART D

6. Indicate whether the following statements are correct or not. Do not repeat the question in your answer script. Incorrect answers will carry Negative (-) marks

- (a) "The discount rate used in the NPV method depends on the risks attributable to a particular industry."
 - (b) "Only IPOs could create new financial securities."
 - (c) "An increase in assets always results in increase in owners' equity."
 - (d) "Depreciation is a non-cash expense item and has no effect on funds."
 - (e) "Short term funds are cheaper than long term funds."
 - (f) "The cost of loan capital is basically the pre-tax interest rate charged by the lender."
 - (g) "After a rights issue the market value a share price declines."
 - (h) "The distribution of energy cost in a factory should be based in the cost of materials used in production."
- (14 Marks)

PART E

7. (a) The following ratios are computed from the Balance Sheet as at 31 March 2005 of Sathchitanada Ltd.

Current Assets to Current Liabilities	2.5
Liquidity Ratio	1.5
Stock Turnover Ratio	6.0
Gross Profit/Sales %	20%
Debt Collection period	2 months
Fixed Asset Turnover	2
Working Capital	Rs. 300,000
Ordinary Share Capital	Rs. 5,500,000
Revenue Reserves	Rs. 2,500,000
Term Loan outstanding	Rs. 1,000,000

Based on the above mentioned information compute the following as at 31 March 2005

- (a) Current Assets (b) Current Liabilities (c) Stocks
 (d) Debtors (e) Cash & Bank (f) Cost of Sales
 (g) Sales (h) Fixed Assets, and

(i) Prepare the Balance Sheet of the Company as at 31 March 2005

(16 Marks)

8. (a) "The Capital Structure of a firm is influenced by a number of practical considerations." Discuss
- (b) Ananda and Nalanda are two recently set up companies having the same overall capital investment. Their financial structures are given below.

	<u>Ananda Ltd</u>	<u>Nalanda Ltd.</u>
Ordinary Shares @ Rs. 10 each	Rs. 1,000,000	Rs. 300,000
Debentures (10% interest)	<u>0</u>	<u>700,000</u>
	<u>1,000,000</u>	<u>1,000,000</u>

The estimated profit of each of the companies for the first year of operations is Rs. 300,000.

This could, however, be higher or lower, depending on the market conditions..

Discuss the impact of the difference in financial structure of the two companies.
 (16 marks)

PART F

9. (a) Discuss briefly, how the following will have an impact on Project Evaluation.

- (i) Replacing an Existing Machine
- (ii) Salvage Value
- (iii) Investment Tax Credit
- (iv) Time Horizon
- (v) Inflation

(b) Kirthi Sri Ltd. is currently engaged in assembling personal computers. The company is considering purchase of plant and equipment in order that the current level of production (4,000 units) could be increased by 25%. The cost of new plant and equipment is estimated at Rs. 1.00M and will have a useful life of 10 years with a salvage value of 5% of the original cost. The company adopts straight line depreciation policy and is eligible for an investment allowance of 25% on new capital expenditure.

It is estimated that under the new proposal the working capital requirements will increase by Rs. 200,000.

The following additional information is available to you.

Variable Cost per Unit	Rs. 50,000
Fixed Cost per annum	1,000,000
Current Selling price per unit	100,000

You also ascertain that the Unit Variable Cost will remain the same, but the fixed cost will increase by the annual depreciation charge for the new plant and equipment. The management of the company estimates that the increased production will lower the selling price by 5% per unit.

The required rate of return : 15 %

- Required:
- (a) prepare the relevant cash flows on account of the proposal
 - (b) determine the NPV of the new proposal to buy new plant and equipment
 - (c) advise the management, based on (b) above

(24 Marks)

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APPENDIX: TABLES

Table 1
Present Value of Re. 1 = $1/(1+r)^n$

Year	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350
12	0.887	0.789	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239
16	0.853	0.728	0.623	0.534	0.458	0.394	0.339	0.292	0.252	0.218
17	0.844	0.714	0.605	0.513	0.436	0.371	0.317	0.270	0.231	0.198
18	0.836	0.700	0.587	0.494	0.416	0.350	0.296	0.250	0.212	0.180
19	0.828	0.686	0.570	0.475	0.396	0.331	0.277	0.232	0.194	0.164
20	0.820	0.673	0.554	0.456	0.377	0.312	0.258	0.215	0.178	0.149
21	0.811	0.660	0.538	0.439	0.359	0.294	0.242	0.199	0.164	0.135
22	0.803	0.647	0.522	0.422	0.342	0.278	0.226	0.184	0.150	0.123
23	0.795	0.634	0.507	0.406	0.326	0.262	0.211	0.170	0.138	0.112
24	0.788	0.622	0.492	0.390	0.310	0.247	0.197	0.158	0.126	0.102
25	0.780	0.610	0.478	0.375	0.295	0.233	0.184	0.146	0.116	0.092
26	0.772	0.598	0.464	0.361	0.281	0.220	0.172	0.135	0.106	0.084
27	0.764	0.586	0.450	0.347	0.268	0.207	0.161	0.125	0.098	0.076
28	0.757	0.574	0.437	0.333	0.255	0.196	0.150	0.116	0.090	0.069
29	0.749	0.563	0.424	0.321	0.243	0.185	0.141	0.107	0.082	0.063
30	0.742	0.552	0.412	0.308	0.231	0.174	0.131	0.099	0.075	0.057

Table 1
Present Value of Re. 1 = $1/(1+r)^n$

Year	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.074	0.065
16	0.188	0.163	0.141	0.123	0.107	0.093	0.081	0.071	0.062	0.054
17	0.170	0.146	0.125	0.108	0.093	0.080	0.069	0.060	0.052	0.045
18	0.153	0.130	0.111	0.095	0.081	0.069	0.059	0.051	0.044	0.038
19	0.138	0.116	0.098	0.083	0.070	0.060	0.051	0.043	0.037	0.031
20	0.124	0.104	0.087	0.073	0.061	0.051	0.043	0.037	0.031	0.026
21	0.112	0.093	0.077	0.064	0.053	0.044	0.037	0.031	0.026	0.022
22	0.101	0.083	0.068	0.056	0.046	0.038	0.032	0.026	0.022	0.018
23	0.091	0.074	0.060	0.049	0.040	0.033	0.027	0.022	0.018	0.015
24	0.082	0.066	0.053	0.043	0.035	0.028	0.023	0.019	0.015	0.013
25	0.074	0.059	0.047	0.038	0.030	0.024	0.020	0.016	0.013	0.010
26	0.066	0.053	0.042	0.033	0.026	0.021	0.017	0.014	0.011	0.009
27	0.060	0.047	0.037	0.029	0.023	0.018	0.014	0.011	0.009	0.007
28	0.054	0.042	0.033	0.026	0.020	0.016	0.012	0.010	0.008	0.006
29	0.048	0.037	0.029	0.022	0.017	0.014	0.011	0.008	0.006	0.005
30	0.044	0.033	0.026	0.020	0.015	0.012	0.009	0.007	0.005	0.004

Table 1
Present Value of Re. 1 = $1/(1+r)^n$

Year	21%	22%	23%	24%	25%	26%	27%	28%	29%	30%
1	0.826	0.820	0.813	0.806	0.800	0.794	0.787	0.781	0.775	0.769
2	0.683	0.672	0.661	0.650	0.640	0.630	0.620	0.610	0.601	0.592
3	0.564	0.551	0.537	0.524	0.512	0.500	0.488	0.477	0.466	0.455
4	0.467	0.451	0.437	0.423	0.410	0.397	0.384	0.373	0.361	0.350
5	0.386	0.370	0.355	0.341	0.328	0.315	0.303	0.291	0.280	0.269
6	0.319	0.303	0.289	0.275	0.262	0.250	0.238	0.227	0.217	0.207
7	0.263	0.249	0.235	0.222	0.210	0.198	0.188	0.178	0.168	0.159
8	0.218	0.204	0.191	0.179	0.168	0.157	0.148	0.139	0.130	0.123
9	0.180	0.167	0.155	0.144	0.134	0.125	0.116	0.108	0.101	0.094
10	0.149	0.137	0.126	0.116	0.107	0.099	0.092	0.085	0.078	0.073
11	0.123	0.112	0.103	0.094	0.086	0.079	0.072	0.066	0.061	0.056
12	0.102	0.092	0.083	0.076	0.069	0.062	0.057	0.052	0.047	0.043
13	0.084	0.075	0.068	0.061	0.055	0.050	0.045	0.040	0.037	0.033
14	0.069	0.062	0.055	0.049	0.044	0.039	0.035	0.032	0.028	0.025
15	0.057	0.051	0.045	0.040	0.035	0.031	0.028	0.025	0.022	0.020
16	0.047	0.042	0.036	0.032	0.028	0.025	0.022	0.019	0.017	0.015
17	0.039	0.034	0.030	0.026	0.023	0.020	0.017	0.015	0.013	0.012
18	0.032	0.028	0.024	0.021	0.018	0.016	0.014	0.012	0.010	0.009
19	0.027	0.023	0.020	0.017	0.014	0.012	0.011	0.009	0.008	0.007
20	0.022	0.019	0.016	0.014	0.012	0.010	0.008	0.007	0.006	0.005
21	0.018	0.015	0.013	0.011	0.009	0.008	0.007	0.006	0.005	0.004
22	0.015	0.013	0.011	0.009	0.007	0.006	0.005	0.004	0.004	0.003
23	0.012	0.010	0.009	0.007	0.006	0.005	0.004	0.003	0.003	0.002
24	0.010	0.008	0.007	0.006	0.005	0.004	0.003	0.003	0.002	0.002
25	0.009	0.007	0.006	0.005	0.004	0.003	0.003	0.002	0.002	0.001
26	0.007	0.006	0.005	0.004	0.003	0.002	0.002	0.002	0.001	0.001
27	0.006	0.005	0.004	0.003	0.002	0.002	0.002	0.001	0.001	0.001
28	0.005	0.004	0.003	0.002	0.002	0.002	0.001	0.001	0.001	0.000
29	0.004	0.003	0.002	0.002	0.002	0.001	0.001	0.001	0.001	0.000
30	0.003	0.003	0.002	0.002	0.001	0.001	0.001	0.001	0.000	0.000