

21ST COMPREHENSIVE EXAMINATION

Marks

CASE # 1

(a)

Statement of Relevant Costs
{Showing Consumption of Two (02) Alternatives for Three (03) Years} (Rs. '000⁺)

Alternatives Particulars	Own Distribution			Outsourced Distribution		
	2012-13	2013-14	2014-15	2012-13	2013-14	2014-15
Annual Relevant Cash Flows						
(i) Cash operating costs	4,200	4,200	4,200	—	—	—
(ii) Subcontract costs	—	—	—	3,900	3,900	3,900
Total: (A)	4,200	4,200	4,200	3,900	3,900	3,900
One Time Relevant Cash Inflows						
Sale of delivery vehicles on:						
(i) April 01, 2012	—	—	—	1,200	—	—
(ii) March 31, 2015	—	—	480	—	—	—
Total: (B)			480	1,200		
Net Relevant Cash Outflows						
(A – B)	4,200	4,200	3,720	2,700	3,900	3,900
Total		12,120			10,500	

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Note: Apportioned corporate cost for the year Rs.600,000 i.e., Rs.1,800,000 for three (03) years. It is corporate cost apportioned to distribution division. Even if it is closed down, this amount is to be incurred by corporate office. Hence this amount is not relevant for decision making. 2

Recommendation:

The offer of distributors can be accepted as it will involve the cash outflow of Rs.10,500,000 during three (03) years as against Rs.12,120,000 by own distribution. Thus there will be a saving of Rs.1,620,000 during three (03) years. 2

(b) Reasoning:

The manufacturing company may be reluctant to accept the offer of distributor for the following reasons:

(i) Loss on sale of vehicles:	(Rs. '000 ⁺)	
Cost of 8 vehicles on July 01, 2011	(480,000 x 8)	= 3,840
Less: Depreciation for 2011-12		840
WDV on July 01, 2012		<u>3,000</u>
Sale	(8 x 150,000)	= 1,200
Loss on sale of 8 vehicles		<u>1,800</u>

(ii) Loss in 2012-13:		
Forecast net profit		1,320
Add: Depreciation avoided		840
Savings in cash operating cost	(4,200,000 - 3,900,000)	= 300
		<u>2,460</u>
Less: Loss on sale of 8 vehicles		<u>1,800</u>
Net profit if offer is accepted		<u>660</u>

Hence the manufacturing company may not accept the offer of distributor due to net decrease in profit on switching the distribution channel.

(iii) The manufacturing company may think that it can serve better the needs of customers by operating its own distribution division. 1

(iv) Security analysts did not analyse the long-term benefits of the offer. 1

21ST COMPREHENSIVE EXAMINATION**Marks****CASE # 2**

- (a) We are informed that our level of cash was Rs.20,000 and that our level of interest was Rs.90,000. Cash represents 5% of our total assets and interest expense represents 6% of our sales. Therefore,

$$\text{Total assets} = \frac{\text{Rs.20,000}}{0.05} = \text{Rs. 400,000} \quad 2$$

$$\text{Sales} = \frac{\text{Rs.90,000}}{0.06} = \text{Rs.1,500,000} \quad 2$$

We can now find the amount of every account in the balance sheet by multiplying the percentage of total assets it represents by Rs.400,000 and in the income statement by multiplying the percentage of sales by Rs.1,500,000.

Balance Sheet
As of June 30, 2012

Cash	Rs. 20,000	Accounts payable	Rs. 32,000	½ + ½
Marketable securities	12,000	Notes payable	20,000	½ + ½
Accounts receivable	36,000	Wages payable	8,000	½ + ½
Inventory	48,000			½
Current assets	Rs. 116,000	Current liabilities	Rs. 60,000	
		Long-term debt	120,000	½
Net fixed assets	284,000	Ordinary share	120,000	½ + ½
		Retained earnings	100,000	½
Total assets	Rs. 400,000	Total liabilities and shareholders' equity	Rs. 400,000	

Income Statement
As of June 30, 2012

Sales	Rs. 1,500,000	
Cost of goods sold	975,000	½
Gross profit	Rs. 525,000	
General, selling and administrative expense	315,000	½
Net operating income	Rs. 210,000	
Interest	90,000	½
Net profit before tax	Rs. 120,000	
Taxes	42,000	½
Net income	Rs. 78,000	½

- (b) We will now calculate 11 ratios for the firm.

Current ratio (116 ÷ 60)	1.9330	Fixed asset turnover (1,500 ÷ 284)	5.28
Quick ratio	1.1330	Operating profit margin	14.00%
Debt-equity ratio (180 ÷ 220)	0.8182	Net profit margin	5.20%
Times interest earned (210 ÷ 90)	2.3330	Return on assets (ROA)	19.50%
Average collection period {36 ÷ (1,500 ÷ 365)}	8.7600	Return on equity (ROE)	35.45%
Inventory turnover (975 ÷ 48)	20.3100		

1 mark for each ratio except = 9
Operating profit margin and = ½
Net profit margin = ½

21ST COMPREHENSIVE EXAMINATION**Marks****(c) (i) Current ratio:**

It indicates the extent to which a firm can meet its short-term obligations.

(ii) Debt-equity ratio:

It indicates the proportions of the firm's assets financed by debt relative to the proportion financed by equity.

(iii) Times interest earned:

It measures how many times interest expenses are earned or covered by profits.

(iv) Average collection period:

It indicates the efficiency of a firm's credit policy i.e., the average length of a time (days) it takes a firm to collect on credit sales.

(v) Inventory turnover:

It indicates the investment in inventories enabling the firm to maintain optimal inventories.

(vi) Fixed-asset turnover:

It measures sales productivity and plant utilization.

(vii) Operating profit margin:

It indicates the profitability of a firm without considering the interest and taxes.

(viii) Price earning ratio:

It indicates the attractiveness of a firm on equity markets.

1 mark for each explanation = 8

THE END