Marks

CASE # 1

(a) New Performance Report for the month:

The cost formulas in the flexible budget below report were obtained by dividing the costs on the static budget in the problem statement by the budgeted level of activity (600 units of stationery and office supplies). The fixed costs are carried over from the static budget. 2

READ Foundation
Flexible Budget Performance Report
for the month ended

Budgeted activity (in units.)	600
Actual activity (in units.)	780

Rs. '000'

Costs	Cost Formula (Per Unit)	Actual Costs Incurred for 780 Units	Budget Based on 780 Units	Variance		Marks
Variable costs:						
Examination expenditures	23.7	18,504	18,486	18	U	3
Books/ stationery supplies	28.7	21,564	22,386	822	F	3
Transportation of material	3.2	2,372	2,496	124	F	3
Administrative supplies	0.5	378	390	12	F	3
Total variable costs	56.1	42,818	43,758	940	F	2
Fixed costs:						
Teachers and staff salaries		26,400	26,400	–		1
Depreciation		4,200	3,800	400	U	2
Rent for premises		3,000	3,000	–		
Utilities		648	600	48	U	2
Total fixed costs		34,248	33,800	448	U	2
Total costs		77,066	77,558	492	F	2

(b) Reasoning of Investigation:

The overall variance is favourable and none of the unfavourable variances is particularly large. 1

Nevertheless, the large favourable variance for expenditures of books and stationery supplies is worrisome. Perhaps the READ Foundation has not been providing books and stationery items to the students. 1

This is well worth investigating and points out that favourable variances may warrant attention as much as unfavourable variances. 1

Some may wonder why there is a variance for depreciation. Fixed costs can change; they just do not vary with the level of activity. Depreciation may have increased because of the acquisition of new equipment or because of a loss on equipment that must be scrapped. 2

Marks

CASE # 2

(a) Usefulness of Ratios:

Ratios are used by managers to help improve the firm's performance, by lenders to help evaluate the firm's likelihood of repaying debts, and by stockholders to help forecast future earnings and dividends. 2

The five major categories of ratios are: liquidity, asset management, debt management, profitability, and market value. 1

(b) Ratios for the Year 2013:

Ratios	Calculations for the Year 2013 (Rupees)	Actual		Projected 2013	Industry Average	
		2011	2012			
Current	Current assets ÷ Current liabilities 8,040,336 ÷ 3,119,400	2.3 x	1.5 x	2.58 x	2.7 x	1
Quick	(Current assets − Inventory) ÷ Current liabilities (8,040,336 − 5,149,440) ÷ 3,119,400	0.8 x	0.5 x	0.93 x	1.0 x	1
Inventory turnover	Sales ÷ Inventory 21,106,800 ÷ 5,149,440	4.8 x	4.5 x	4.10 x	6.1 x	1
Days sales outstanding	Receivables ÷ (Sales ÷ 365) 2,634,000 ÷ (21,106,800 ÷ 365)	37.3	39.6	45.5	32.0	1
Fixed assets turnover	Sales ÷ Net fixed assets 21,106,800 ÷ 2,510,520	10.0 x	6.2 x	8.41 x	7.0 x	1
Total assets turnover	Sales ÷ Total assets 21,106,800 ÷ 10,550,856	2.3 x	2.0 x	2.0 x	2.5 x	1
Debt ratio	Total liabilities ÷ Total assets (3,119,400 + 1,500,000) ÷ 10,550,856	54.8 %	80.7 %	43.8 %	50.0 %	1
Times interest earned	EBIT ÷ Interest 1,507,920 ÷ 240,000	3.3 x	0.1 x	6.3 x	6.2 x	1
EBITDA coverage	(EBITDA + Lease payments) ÷ (Interest + Loan repayments + Lease payments) (1,507,920 + 360,000 + 120,000) ÷ (240,000 + 120,000)	2.6 x	0.8 x	5.5 x	8.0 x	2
Profit margin	Net income ÷ Sales 757,752 ÷ 21,106,800	2.6 %	–1.6 %	3.6 %	3.6 %	1
Basic earning power	EBIT ÷ Total assets 1,507,920 ÷ 10,550,856	14.2 %	0.6 %	14.3 %	17.8 %	1

Marks

Ratios	Calculations for the Year 2013 (Rs. '000')	**Actual 2011**	**Actual 2012**	**Projected 2013**	**Industry Average**	Marks
Return on assets	Net income ÷ Total assets 760,752 ÷ 10,550,856	6.0 %	–3.3 %	7.2 %	9.0 %	1
Return on equity	Net income ÷ Ordinary equity 760,752 ÷ 5,931,456	13.3 %	17.1 %	12.8 %	17.9 %	1
Price/ earnings (P/E)	Price per share ÷ Earnings per share 36.51 ÷ (Net income ÷ Share outstanding) 36.51 ÷ (760,752 ÷ 250,000) 36.51 ÷ 3.0430	9.7 x	–6.3 x	12.0 x	16.2 x	1
	Check: Price = EPS x P/E = 3.0430 x 12.0 = 36.51					1
Price/ Cash flow	36.51 ÷ {Cash flow ÷ Shares} 36.51 ÷ {(NI + DEP) ÷ Shares} 36.51 ÷ {(760,752 + 360,000) ÷ 250,000} 36.51 ÷ 4.48!	8.0 x	27.5 x	8.1 x	7.6 x	2
Market/ Book	Market price per share ÷ Book value per share 36.51 ÷ (Ordinary equity ÷ Shares outstanding) 36.51 ÷ (5,931,456 ÷ 250,000) 36.51 ÷ 23.73	1.3 x	1.1 x	1.54 x	2.9 x	2

(c) Strengths and Weaknesses:

Strengths:

The company's fixed assets turnover was above the industry average. However, if the company's assets were older than companies in the industry this could possibly account for the higher ratio. (Gama Company's fixed assets would have a lower historical cost and would have been depreciated for longer periods of time.) The company's profit margin is slightly above the industry average, despite its higher debt ratio. This would indicate that the company has kept costs down, but, again, this could be related to lower deprecation costs. 2

Weaknesses:

The Company's liquidity ratios are low; most of its asset management ratios are poor (except fixed assets turnover); its debt management ratios are poor, most of its profitability ratios are low (except profit margin); and its market value ratios are low. 1

Du Pont Equation:

Du Pont Equation = Profit margin x Total assets turnover x Equity multiplier 2

= 3.6% x 2.0 x (Rs. 10,550,856,000 ÷ Rs. 5,931,456,000) 1

= 3.6% x 2.0 x 1.778 = 12.8% 1

THE END