Sr. No. 001

INSTITUTE OF COST AND MANAGEMENT ACCOUNTANTS OF PAKISTAN

5th Comprehensive Examination

Sunday, the 10th August, 2008

Time Allowed – 2 Hours **Maximum Marks – 60**

(i) Attempt both the cases 1 and 2, that carry 30 marks each.

(ii) Answers must be neat, relevant and brief.

(iii) In marking the question paper, the examiners take into account the clarity of exposition, logic of arguments, effective presentation, language and use of clear diagram or chart where appropriate.

(iv) Read the instructions printed on the top cover of answer script CAREFULLY before attempting the paper.

(v) Use of non-programmable scientific calculators of any model is allowed.

(vi) DO NOT write your Name, Reg. No. or Roll No. anywhere inside the answer script.

(vii) Question No. 1 – "Multiple Choice Question" printed separately, is an integral part of this question paper.

CASE NO- 1

Marks

The management of Al-Rumah Hotel Ltd., has prepared the budget, which shows the following room occupancy:

	Average %
January – March	45
April – June	60
July – September	90
October – December	55

Revenue for the year is estimated to be Rs.24,000,000 and arises from three profit centres;

Accommodation	45 %
Restaurant	35 %
Bar	20 %
Total	100 %

The accommodation revenue is earned from several different categories of guest each of which pays a different rate per room.

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The three profit centres have the following percentage gross margins: **Marks**

	Accommodation %		Restaurant %		Bar %	
Revenue		100		100		100
Wages	20		30		15	
Cost of sales	–		40		50	
Direct costs	10	30	10	80	5	70
		70		**20**		**30**

Fixed costs for the year are estimated to be Rs.4,520,000.

Capital employed is Rs.56,000,000.

As a means of improving the Return of Capital Employed (ROCE) two suggestions have been made;

(i) to offer special two-night holidays at a reduced price of Rs.200 per night. It is expected that those accepting the offer would spend an amount equal to 40% of the accommodation charge in the restaurant, and 20% in the bar. The gross margin percentages for the three profit centers would remain same as indicated above.

(ii) to increase prices, management is confident that there will be no drop in volume of sales if restaurant prices are increased by 18% and bar prices by 10%. Accommodation prices would also need to be increased.

Required:

(a) Calculate the budgeted return on capital employed before tax; and 10

(b) Calculate;

(i) how many two-night holidays would need to be sold each week in the four quarters to improve the return on capital employed by a further 4% above the percentage calculated in (a) above. 10

(ii) By what percentage the prices of accommodation would need to be increased to achieve the desired ROCE shown in (b) (i) above. 10

CASE NO- 2

Marks

(a) The Sportswear Ltd., is considering a new location. If it constructs a sports outlet and manufactures 100 cricket helmets the cost will be Rs.200,000 and the project is likely to produce net cash flows of Rs.34,000 per year for 15 years, after which the leasehold on the land expires and there will be no residual value. The company's required return is 18 percent. If the location proves favorable, Sportswear Ltd., will be able to expand by another 100 helmets at the end of 4 years. The cost per helmet would be Rs.400. With the new helmets, incremental net cash flows of Rs.34,000 per year for years 5 through 15 would be expected. The company believes there is a 50 – 50 chance that the location will prove to be a favorable one.

Required:

(i) Is the initial project acceptable? 05

(ii) What is the value of the option? The worth of the project with the option? Is it acceptable? 15

(b) Birds & Birds Co., has launched an expansion program that, in 6 years, should result in the saturation of the coastal area marketing region of Sindh. As a result, the company is predicting a growth in earnings of 12 percent for 3 years, 6 percent for years 4 through 6, then constant earnings for the foreseeable future. The company expects to increase its dividend per share, now Rs.24, in keeping with this growth pattern. Currently, the market price of the stock is Rs.300 per share.

Required:

Estimate the company's cost of equity capital. 10

THE END