Department of Finance and Investment Management

Financial Management 2C
BSR2C01

LAST ASSESSMENT OPPORTUNITY
30 MAY 2016

Time: 10 minutes reading time & 120 minutes writing time
Marks: 100

Assessor: Ms M Dolamo CA (SA)
Moderator: Mr B Mogapi CA (SA)

INSTRUCTIONS:
• This paper consists of 8 pages.
• Answer ALL questions in the answer book provided.
• Silent, non-programmable calculators may be used, unless otherwise instructed.
• Where applicable, show all calculations clearly.
• Answers with Tippex and in pencil will not be marked.
• Scratch out all open spaces and empty pages.
• HAND IN YOUR QUESTION PAPER AND ALL ANSWER BOOKS.
• Good luck!

<table>
<thead>
<tr>
<th>Question</th>
<th>Topic</th>
<th>Marks</th>
<th>Time</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section A</td>
<td>Objective test questions – various topics</td>
<td>20</td>
<td>24 minutes</td>
</tr>
<tr>
<td>Section B</td>
<td>Short Questions</td>
<td>20</td>
<td>24 minutes</td>
</tr>
<tr>
<td>Section C</td>
<td>Long Questions</td>
<td>60</td>
<td>72 minutes</td>
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<tr>
<td>Overall</td>
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<td>100</td>
<td>130 minutes</td>
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SECTION A  

QUESTION 1  

REQUIRED:  
State whether the following statements are TRUE or FALSE. Motivate your answer in each case.

1. **Statement 1:**  
   First (Pty) Ltd has both fixed and variable costs. If the production volume doubles, the total fixed costs will also double.  

2. **Statement 2:**  
   Direct materials is an example of a fixed cost.  

3. **Statement 3:**  
   Public accountants conduct annual audit on managerial accounting reports.  

4. **Statement 4:**  
   Selling and administration cost is an example of a product cost.  

5. **Statement 5:**  
   The three basic components of manufacturing costs are direct material, direct labour and costs of goods sold.  

6. **Statement 6:**  
   The wages of a production worker in a shoe manufacturing company is based on the quantity of shoes produced, this is an example of a variable cost.  

7. **Statement 7:**  
   Cost of research and development in a new mining company is an example of an opportunity cost.  

8. **Statement 8:**  
   The NPV method of project evaluation is superior to the payback period method because the payback period method does not takes into account the time value of money.  

9. **Statement 9:**  
   If a unit sells for R11.40 and has a variable cost of R3.80, its contribution margin ratio is R7.60.  

10. **Statement 10:**  
    One of the short falls of payback method is that it ignores cash flows after pay back period.
SECTION B [20 MARKS]

QUESTION 2 (10 Marks)

Second Avenue (Pty) Ltd manufactures a range of bikes and scooters. The company is at present considering investing in one of the following mutually exclusive projects and on average they require a return of 20%.

- **Project Hard Helmet**
  This project will cost R150 000 initially, and will generate net cash inflows of R50 000 per year.

- **Project Side Saddle**
  Being a more luxurious product, the initial cost of this project will be higher at R339 000. The net cash inflows will be R60 000 per year and it has a life span of 10 year.

Management has set a target payback period of 3, 5 years for all capital projects.

**REQUIRED:**

2.1 Calculate and Indicate which of the two projects will be selected if the payback method is used.  
2.2 Calculate and advice if Second Avenue should invest in Project Side Saddle using Internal Rate of Return method.
QUESTION 3  

(10 Marks)

Third Avenue (Pty) Limited is a paint manufacturing company. The company’s marginal costing operating statement for the current financial year is as follows:

<table>
<thead>
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<th>R</th>
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<tr>
<td>Sales (R4 per unit)</td>
<td>20,000</td>
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<tr>
<td>Variable costs</td>
<td>8,000</td>
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<tr>
<td>Contribution</td>
<td>12,000</td>
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<tr>
<td>Fixed cost</td>
<td>7,500</td>
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<tr>
<td>Profit</td>
<td>4,500</td>
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REQUIRED:

3.1 Calculate the break-even point in units and discuss what this amount indicates.  
3.2 Calculate the margin of safety as a percentage and in value and discuss what this value or percentage indicates.
Fourth Avenue (Pty) Ltd is expanding their international brand to Gauteng by opening their first clothing outlet in Sandton City in 2017. Management approached you to help prepare the budget for the 2017 summer and autumn months.

You were provided with the following information:

<table>
<thead>
<tr>
<th>Month</th>
<th>Sales Forecast (Units)</th>
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<tr>
<td>January</td>
<td>35 000</td>
</tr>
<tr>
<td>February</td>
<td>37 500</td>
</tr>
<tr>
<td>March</td>
<td>42 500</td>
</tr>
<tr>
<td>April</td>
<td>52 500</td>
</tr>
<tr>
<td>May</td>
<td>51 500</td>
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</table>

Additional information:

- The selling price is R10/unit.
- 80% of the total sales are on credit terms and 20% are for cash. The collection pattern for credit sales is as follows:
  - 60% during the month following the month of sale.
  - 40% is collected two months after the original sale.
- Ending stock is equal to 10% of the following month’s budgeted sales in units, on the 31st December 2016, 5 000 units were on hand.
- Material purchases in each month are equal to 30% of total sales amount forecast for the next month. The purchases in each month are paid for in the month after purchase.
- Production is scheduled at the level of forecast sales for the following month.
- Labour expenses are equal to 45% of forecast sales of the following month and are payable in the month of production.
- Selling and administrative expenses of R40 000 per month are paid in the month incurred.
- Interest expense of R18 500 on borrowings is due on 30 June 2017.
- Overhead expenses of R45 000 per month are paid in the following month.
- An estimated tax payment of R20 000 will be paid on 15 April.
- No dividends will be paid
- Actual total sales for November and December 2016 were R400 000 per month.
- Depreciation expenses are R5 000 per month.
- The cash balance on 31 December 2016 was R50 000.

**REQUIRED:**

4.1
Prepare the following budgets for January to April 2017:

a) Sales budget. (4)

b) Production budget. (7)

4.2
Prepare a cash budget for Fourth Avenue for the months January to April 2017 (Show all calculations, including the expected cash collections per month) (23)

4.3
Discuss the disadvantages of budgeting for a company like Fourth Avenue. (6)
The Managing Director of Fifth Avenue (Pty) Ltd is evaluating the performance of the managers in the cost, profit and investment centres and has given you the following information and asked for your assistance:

- The company has targeted to achieve a return of 15% on its investment in operating assets.
- Profit before finance charges and taxation is R75 698.
- Return on Investment (ROI) is 25%.

REQUIRED:

5.1 Calculate how much has Fifth Avenue (Pty) Ltd paid for its operating assets. (3)

5.2 Identify 3 ways on how to improve ROI. (3)

5.3 Assuming you arrived at a total amount of R275 000 in 5.1 Above (i.e. Assuming Fifth Avenue has invested R275 000 in operating assets) Calculate the Company’s Residual Income. (6)

5.4 Discuss the differences between cost and profit centres and explain how the performance of each of these centres is measured. (4)

5.5 Identify four (4) benefits of decentralization. (4)
Annexure A

Present Value Factor for an Ordinary Annuity

(Interest rate = r, Number of periods = n)

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