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THE OPEN UNIVERSITY OF SRI LANKA
BACHELOR OF MANAGEMENT STUDIES (HONOURS) DEGREE PROGRAMME
LEVEL 05
FINAL EXAMINATION – 2019
FINANCIAL MANAGEMENT AND MANAGERIAL ACCOUNTING – MCU3208/MSU5508
DURATION: THREE (03) HOURS

Date: 19.01.2020	Time: 1.30pm – 4.30pm

Answer five (05) Questions selecting as follows.
Any two (2) questions from part A.
Any three (3) questions from part B.
Use of a non-programmable calculator is allowed.

PART A

(1) i. What are the functions of Management Accounting? Explain. (10 Marks)
ii. 'Cost Accounting is an aid to Management Accounting" Discuss. (05 Marks)
iii. Explain the difference between Cost Accounting and Management Accounting. (05 Marks)

(2) i. "The break-even point is reached at a lower level of activity in the undertaking with a low fixed cost. Critically comment on the above statement. (05 Marks)

ii. Alfa Ltd., produces four products in its factory. The volume of production and sales achieved is considerably lower than normal so there has been substantial under-recovery of overheads. The sales and cost particulars (in Rs. million) are as follows.

	Product			
	A	B	C	D
Sales	160	2000	80	40
Direct materials	24	32	16	3
Direct wages	40	48	32	8
Factory overheads	48	64	40	8
Selling and Admin Expenses (15% of sales)	24	30	12	6
Profit (Loss)	24	26	(20)	15

40% of factory overheads vary at normal volumes and the selling and administration overheads vary to the extent of 5% of sales. 20% of sales of product C is done in conjunction with product A and as much as the discontinuance of product C will bring down the sales of product A by 10%.

(a) Prepare a contribution format income statement. (04 Marks)

(b) In view of the loss reported for product C, the management is considering discontinue it. In that event the company can save a sum of Rs. 8 million in fixed expenses. What is the financial implication of discontinuing product C? (05 Marks)

iii. The P/V (profit volume) ratio of a company is 50% and the margin of safety is 40%. You are required to calculate the BEP (Break-even point) and the net profit if the volume of sales is Rs.800,000/=. (06 Marks)

(3) (i) Explain the difference between relevant costs, irrelevant costs and sunk costs. (04 Marks)

(ii) A company manufactures and markets three products that are made from the same set of machines. Production is limited by machine capacity. Using the data given below, you are required to indicate the priorities for products A, B, and C with a view to maximize profits.

	A	**B**	**C**
		(Cost per unit)	
Raw materials (Rs.)	2.25	3.25	4.25
Direct Labour (Rs.)	0.50	0.50	0.50
Other Variable Cost (Rs.)	0.30	0.45	0.71
Selling Price (Rs.)	5.90	6.00	7.00
Standard machine Time required (per unit)	39 minute	20 minutes	28minutes

(10 Marks)

(iii) In the following year, the company faces extreme shortage of raw materials. It is noted that 3kg, 4kg, 5kg of raw materials are required to produce one unit of A, B, and C respectively. How would product priorities change". (06 Marks)

PART B

(4) (i) "Financial management is mainly concerned with obtaining required funds in the appropriate mix and utilizing them efficiently". Explain. (08 Marks)

(ii) "The wealth maximization objective of a firm is superior to its profit maximization objectives" Do you agree? Explain. (12 Marks)

(5) (i) What do you mean by time value of money? (05 Marks)

(ii) Investments we make today generate cash flows at different time intervals in the future. This makes the evaluation process complicated. How do you address this issue when evaluating investment projects? (05 Marks)

(iii) A family borrows Rs.600,000 loan at 10% interest and agrees to pay the loan with 4 equal annual installments.

a) If the first installment is paid at the end of the year, what is the value of an installment?

b) Prepare an amortization schedule showing how the interest and the principal are paid over the period.

c) What is the total interest paid during the 4 year period? (10 Marks)

(6) (i) Whenever the returns from the individual securities are not perfectly positively correlated, the risk of any portfolio of these securities may be reduced through the effects of diversification" Do you agree? Explain. (06 Marks)

(ii) Assume that stock A had an average return of 11.3 with a standard deviation of 20.79. Stock B had an average return of 10.3 with a standard deviation of 18.70. The correlation between the returns of the two stocks is 0.88.

a) If you are risk averse, would you prefer to invest all in Stock A, all in Stock B, or in the portfolio? Why? (08 Marks)

(iii) Based on the following information, calculate the expected rate of return and risk of the security.

State of Economy	Probability	Rate of Return
Boom	0.2	0.30
Normal	0.7	0.12
Recession	0.1	-0.05

(06 Marks)

(7) (i) Define the term cost of capital. (02 Marks)

(ii) The capital structure for ABC Ltd. is given below.

	Rs.
8% Debentures	4,00,000
9% Preference shares	1,00,000
Equity Shares	5,00,000
	1,00,000

New debentures would be sold at 10% coupon rate and will be sold at par. Preference shares will have an 11% rate and will also be sold at par. Equity shares currently selling at Rs. 100/= can be sold at net the company is Rs.95/=. Management expects to pay a fully franked dividend at the end of the year of Rs.4/= and dividend should increase at an annual rate of 8% thereafter. The corporate tax rate is 50%.

You are required to

(a) Calculate cost of debt, cost of preference capital and cost of equity capital

(b) Calculate the weighted average cost of capital. (10 Marks)

(iii) A company is contemplating an issue of new equity shares. The firms equity shares are currently selling at Rs.125/= a share. The historical pattern of dividend payments per share, for last 5 years is given below.

Years	2015	2016	2017	2018	2019
Dividend	10.70	11.45	12.25	13.11	14.03

The flotation costs are expected to be 3% of the current selling price of the shares. You are required to calculate;

a) Growth rate in dividends

b) Cost of equity capital, assuming growth rate determined under situation (a) continues for ever

c) Cost of new equity shares (08 Marks)