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THE OPEN UNIVERSITY OF SRI LANKA
BACHELOR OF MANAGEMENT STUDIES DEGREE PROGRAMME
LEVEL 05
FINAL EXAMINATION – 2018
FINANCIAL MANAGEMENT AND MANAGERIAL ACCOUNTING – MCU3208
DURATION: THREE (03) HOURS

No. of Pages 05
No. of Questions 07

Date: 27th October 2018

Time: 9.30 am – 12.30 pm

*Answer five (5) Questions only selecting as follows.
Any two (2) questions from part A and any three (3) questions from part B.
Use of non-programmable calculator is allowed.*

PART A

- (1) I) What is Management Accounting? (05 Marks)
- II) Explain the basic characteristics of Management Accounting (15 Marks)
- (2) I) 'Margin of safety serves as a reliable indicator of business strength and Soundness'. Do you agree? Explain. (05 Marks)
- II) Cadilac Apparel produces variety of garments for their customers. The following cost items have been extracted in relation to the T-Shirt "Pink Elephant" produced for teenagers.
- a) The company uses semi-automated machines with a capacity of 3,000 units for a month. The monthly rental for the machine is Rs. 100,000/=.
- b) The cutting of cloth and sewing of the T-shirt are carried out using labour. For this purpose, company has employed two permanent workers for cutting of cloth for a monthly salary of Rs. 50,000/= for an employee. Cost of sewing is Rs. 100/= per T-shirt.
- c) Two meters of cloth is required for producing one unit of this T-shirt. The company is currently purchasing one meter of cloth for a cost of Rs. 200/=.
- d) Costs of buttons, lace and other materials are estimated as 50/= per unit.

- e) The monthly salary of the company's marketing manager is Rs. 75,000/=. When the sales exceed 2000 units in a month, he is paid a commission of Rs. 50/= for every unit in excess of this 2,000 units.

Using above information;

- (i) Discuss the behavior of the cost items from a) to e) given above, clearly stating the type of the behaviour observed. (05 Marks)
- (ii) Prepare a contribution format income statement of selling 2,000 units at Rs. 750/= per unit in a month. (05 Marks)
- (iii) A special order has been received from a private company for 200 units for their employees with the company name printed. The cost of printing the company name is Rs.40/= each. The price offered by this company for an item is Rs. 600/= per unit. Decide whether this special order should be accepted? Justify your answer with necessary calculations. (05 Marks)
- (3) I) "In order to evaluate cost information, managers must be able to distinguish between relevant costs and irrelevant costs". Explain this statement using an appropriate example. (05 Marks)
- II) A company is evaluating its make versus buy decisions for several of its products. For one product, the costs per unit are as follows.

| | |
|--|--------------|
| | Rs. |
| Direct Materials | 7.50 |
| Direct Labour | 5.00 |
| Variable Manufacturing | 1.00 |
| Fixed traceable manufacturing overhead | 2.00 |
| Fixed common manufacturing overhead | 2.50 |
| | <u>10.00</u> |

The current level of production is 1000 units. Of the traceable manufacturing overhead, 50% consists of amortization of special equipment that has no salvage value and 50% consists of salaries that could be avoided if the production of this product is discontinued.

An outside supplier is willing to sell this product to the company at a price of Rs.15/= per unit if the company purchases 1000 units.

- (i) Assess whether the company should continue to produce this product internally or whether it should be purchased from the outside supplier? (05 Marks)
- (ii) What are the qualitative factors that should be considered in deciding whether to make or buy? (04 Marks)

III) A manufacturing company produces three types of products; X, Y, and Z. The estimated cost and sales data are given below.

| | X | Y | Z |
|---|-----|-----|-----|
| Direct material cost per unit (Rs.50/= per kg) (Rs.) | 100 | 200 | 250 |
| Direct labour cost per unit (Rs. 10/- per hour) (Rs.) | 40 | 30 | 20 |
| Selling price per unit (Rs.) | 200 | 310 | 400 |
| Monthly demand (in units) | 200 | 500 | 450 |

Using above information, determine the company's production plan under each of the following situations.

- a) The raw materials supply is limited to 2,500 kg in next month.
 b) The availability of direct labour hours is limited to 2,350 hours in next month. (06 Marks)

PART B

(4) I) "Although Shareholders Wealth Maximization is the primary financial objective, companies usually have responsibility to other stakeholder as well".

- (a) Explain briefly objective of shareholders' wealth maximization. (05 Marks)
 (b) Discuss the above statement in relation to the social responsibility of an organization. (05 Marks)

II) "As business becomes larger and more complex, a finance manager's task become more pervasive and significant in solving the complex management problems". Discuss this statement highlighting the role of a finance manager in a modern business organization.

(10 Marks)

- (5) I) (a) What is meant by time value of money? Explain. (04 Marks)
 (b) Why consideration of time is important in financial decision making? How time can be adjusted? Illustrate your answer. (06 Marks)
- II) (a) Some practicing financial analysts focus on Earnings Per Share (EPS) as a major determinant of a firm's share price. Explain the link between EPS and the share price. (03 Marks)
- (c) ABC Ltd. is expected to have EPS of Rs.8/=. Out of these earnings 40% will be retained within the firm for reinvestment and 60% will be paid out as dividends to shareholders this year. Management expects to earn a 18% return on equity and investors have 12% required rate of return. Calculate the value of a share of ABC Ltd. (07 Marks)

- (6) I) What are the two elements of stocks return. (02 Marks)
- II) Distinguish between realized rate of return and expected rate of return. (02 Marks)
- III) Explain the importance of correlation of security returns in forming investment portfolio. (04 Marks)
- IV) The following information relates to the investment in the equity shares of Alfa PLC. The shares were bought on 1st January 2014 at Rs. 25/= each.

| Year | Dividend (Rs.) | Share price at the end (Rs.) |
|------|----------------|------------------------------|
| 2014 | 1.20 | 30.50 |
| 2015 | 1.40 | 30.75 |
| 2016 | 1.50 | 38.20 |
| 2017 | 1.50 | 45.10 |

You are required to;

- (a) Calculate Dividend Yield, Capital Gain and Annual Rate of Return for the above share. (06 Marks)
- (b) Calculate the Average Rate of Return and Standard Deviation of Return. (06 Marks)
- (7) I) (a) Define the cost of capital. (03 Marks)
 (b) Which source of capital do you consider when computing the cost of capital, (02 Marks)
 (c) How does a firm's tax rate affect its cost of debt capital. (03 Marks)

- II) Lancaster Engineering Ltd. has the following capital structure, which is considered to be optimal.

| | Rs. |
|-------------------------------|----------------|
| Equity shares (10,000 shares) | 150,000 |
| 8% Debentures | 60,000 |
| 9% Preference Shares | 40,000 |
| | <u>250,000</u> |

The company's shares are sold at a current market price of Rs.26/= per share. The past trend of Earnings Per Share (EPS) is as follows.

| Year | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|------|------|------|------|------|------|------|------|------|------|
| EPS | 2.75 | 3.25 | 3.32 | 3.66 | 4.06 | 4.42 | 4.17 | 5.35 | 5.98 |

The past trends are expected to continue. The expected dividend per share next year is 60% of the EPS of 2017. Further;

- The new debenture can be issued at a coupon rate of interest of 8.5%.
- Debentures are sold at Rs. 94/= each
- The new preference share capital will fetch a net price of Rs.18/= paying a dividend of Rs. 4/= per share.
- The current tax rate is 50%.

You are required to calculate.

- After tax cost of debt,
- Cost of new preference share capital
- Cost of equity capital.
- The weighted average cost of capital assuming that no new equity shares are sold.

(Marks 12)

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