

THE OPEN UNIVERSITY OF SRI LANKA
 COMMONWEALTH EXECUTIVE MASTER OF BUSINESS/ PUBLIC
 ADMINISTRATION
 FINAL EXAMINATION 2016
 MCP 1609 - ACCOUNTING AND FINANCE
 DURATION - 03 HOURS



Date: 30th November 2016

TIME: 09.30am to 12.30pm

Instructions: Answer all five (05) questions

Numbering of the answer in your answer script should follow the numbers assigned to the questions in the paper.

Illegible hand writing is liable to decrease marks.

Use of Non-programmable calculator is allowed.

Question No (01)

- a) Why do businesses need to produce financial statements? (02 Marks)
- b) "In understanding the financial situation of a company, its **liquidity** and the **solvency** take an important position"
 What is meant by term liquidity and solvency? (04 Marks)
- c) What are the primary purposes of preparing following financial statements by a company?
 i. Statement of Financial Position
 ii. Statement of Income
 iii. Statement of Cash Flow (06 Marks)
- d) Why is it necessary to audit financial statements of a limited liability company by independent auditors? (04Marks)
- e) "The work carried out by professional accountants in preparing and auditing financial statements is relied upon by number of parties that expect a true and fair view of a business's financial position and performance to be presented".
 What are the ethical requirements of financial reporting? Explain.

(04Marks)

(Total 20 Marks)

Question No (02)

Following information extracted from the financial statements of Hello Tel Company Ltd., published for the year 2015/2016.

Income Statement**(Rs.000)**

	2015/2016		2014/2015	
Sales		42,375		38,000
Cost of Sales		(30,375)		(27,500)
Gross profit		12,000		10,500
Other Income		355		200
		12,355		10,700
Distribution Expenses	1,880		2,100	
Administrative Expenses	4,836		5,354	
Other Expenses	495		565	
Financial Expenses	520		616	
		(7,731)		(8,635)
Profit before Tax		4,624		2,065
Tax		(1,125)		(725)
Profit after Tax		<u>3,499</u>		<u>1,340</u>

Statement of Financial Position**(Rs.'000)**

	31.03.2016		31.03.2015	
Assets				
Non Current Assets				
Property Plant & Equipment		27,066		28,777
Investment		4,110		-
Fixed Deposit		<u>3,900</u>		<u>3,900</u>
		35,076		32,677
Current Assets				
Inventory	3,120		2,160	
Trade Receivables	4,560		2,480	
Other Current Assets	-		30	
Cash and Cash Equivalents	<u>430</u>		<u>390</u>	
		<u>8,110</u>		<u>5,060</u>
Total Assets		<u>43,186</u>		<u>37,737</u>
Equity & Liabilities				
Equity				
Capital & Reserves				
Stated Capital	30,000		26,400	

Reserves	5,010		5,010
Retained Profit	<u>2,776</u>		<u>(73)</u>
Total Equity	37,786		31,337
Liabilities			
Non Current Liabilities			
Bank Loan - Peoples Bank		1,500	1,800
Current Liabilities			
Trade Payables	2,085		2,314
Tax Payables	342		460
Dividend Payables – Preference Share	150		-
Current Portion of Loan Payable	<u>1,323</u>		<u>1,826</u>
		3,900	4,600
Total Equity and Liabilities		<u>43,186</u>	<u>37,737</u>

Following additional information is also available

- During the year 2015/2016 Rs. 450,000 and Rs.200, 000 had been paid as dividends for ordinary shares and preference shares respectively. In the year 2014/2015 Rs.200, 000 was paid as preference dividends.
- While the number of ordinary shares issued as at 01.04.2015 was 1,000,000 and another 200,000 new ordinary shares were issued at a rate of Rs.18 per share on 01.01.2016.
- 80% of sales and 70% of purchases on credit basis
- Market price of ordinary shares was Rs.22 on 31.03.2016 and it was Rs. 16 on 31.03.2015
- Following balances are available at 31.03.2014

Stock	Rs.2, 680,000
Trade Receivables	Rs. 3,200,000
Trade Payables	Rs. 2,922,000

a. You are required to calculate the following ratios for both years.

- | | | | |
|-----|----------------------------|------|----------------------------------------------------------------------------------|
| i | Gross Profit Ratio | vi | Inventory Turnover period |
| ii | Net Profit Ratio | vii | Average Debtor collection period |
| iii | Return on Capital Employed | viii | Average Period of Accounts Payable |
| iv | Current Ratio | ix | Earnings per Share |
| v | Quick Assets Ratio | x | Price Earnings Ratio (Treat the assets at the end of the year as average assets) |

(10 Marks)

b. Explain the financial position and profitability of the company relative to the previous year, based on your calculations.

(10 Marks)

(Total 20 Marks)

Question No (03)

- a. Explain the term working capital. What is the primary objective of working capital management? **(04 Marks)**
- b. What are the factors that affect the working capital requirements of a business? **(04 Marks)**
- c. Briefly explain the three main working capital management policies followed by business organizations. **(06 Marks)**
- d. Following information was extracted from PQR Ltd.

Value Rs.

Inventory	140,000
Debtors	90,000
Cash in Hand	70,000
Creditors	100,000
Bank Overdraft	75,000
Accrued Expenses	45,000

You are required to Calculate

- 1) Gross Working Capital
- 2) Net Working Capital **(06 Marks)**

(Total 20 Marks)

Question No (04)

A toilet soap manufacturer produce a toilet soap at a markup of Rs.50/= for each unit. Costs of the production are as follows.

	Cost Value (Rs.)
Direct material per unit	12/=
Direct Labour per unit	10/=
Other direct cost per unit	03/=
Fixed overhead per unit	13/=
Fixed Cost of the Production	3,000,000/=
Forecasted Sales in Units	225,000/=

- (a) Calculate the Contribution per Unit **(02 Marks)**
- (b) Calculate the Contribution Sales Ratio **(02 Marks)**

- (c) Calculate the Break Even Point of new product in unit & value **(04 Marks)**
- (d) Calculate the Margin of Safety **(02 Marks)**
- (e) Calculate the profit of the entity **(02 Marks)**
- (f) If selling price of the toilet soap goes up by Rs 5/=, what is the new Break Even Point in units? **(02 Marks)**
- (g) Assume the manufacturer needs to achieve a target profit of Rs.1, 000,000/= from this production during the specified period. How many units should be sold to achieve this target profit before the price goes up as mentioned in the above (f)? **(03 Marks)**
- (h) After the government imposed few taxes recently, the manufacturer forecasts that he needs to pay Rs. 350, 000/= income tax for this production, How many units should be produced to cover tax liability and target profit after the price goes up as mentioned in the above (f)? **(03 Marks)**
- (Total 20 Marks)**

Question No (05)

a)

ABC Ltd is a company in the construction industry. Information related to one of their construction projects given below.

Capital expenditure (Rs.'000)	300,000
Net Cash inflows (Rs.'000)	
Years 1	60,000
Years 2	90,000
Years 3	100,000
Years 4	120,000
Years 5	80,000

- i. You are required to calculate payback period of the project **(02 Marks)**
- ii. If the required rate of the return of the investor is 10%, Calculate NPV and the IRR of the project **(08 Marks)**
- b) The dividend on Max Company Plc's ordinary share will be Rs.3/= in the 1st year, Rs.5/= in the 2nd year, and Rs. 7/= in the 3rd year. The share can be sold for Rs.100/= at the end of the 3rd year. If investor's required rate of return is 12%, calculate the intrinsic value of this share. If the market price of the share is Rs 72/= at present, would you recommend to buy this share? **(04 Marks)**

- c) An investor has three bonds (P, Q and R) in his portfolio with a face value of Rs.1000/= and annual coupon rate is 12% for all three bonds. Bond "P" matures in 12 years, and Bond "Q" matures in 05 years and Bond "R" matures in 07 years.

What will be the value of each bond, if the investor's required rate of return is 08%?

(06 Marks)

(Total 100 Marks)

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PRESENT VALUE TABLE

Present value of \$1, that is $(1+r)^{-n}$ where r = interest rate; n = number of periods until payment or receipt.

Periods (n)	Interest rates (r)									
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	0.980	0.961	0.943	0.925	0.907	0.890	0.873	0.857	0.842	0.826
3	0.971	0.942	0.915	0.889	0.864	0.840	0.816	0.794	0.772	0.751
4	0.961	0.924	0.888	0.855	0.823	0.792	0.763	0.735	0.708	0.683
5	0.951	0.906	0.863	0.822	0.784	0.747	0.713	0.681	0.650	0.621
6	0.942	0.888	0.837	0.790	0.746	0.705	0.666	0.630	0.596	0.564
7	0.933	0.871	0.813	0.760	0.711	0.665	0.623	0.583	0.547	0.513
8	0.923	0.853	0.789	0.731	0.677	0.627	0.582	0.540	0.502	0.467
9	0.914	0.837	0.766	0.703	0.645	0.592	0.544	0.500	0.460	0.424
10	0.905	0.820	0.744	0.676	0.614	0.558	0.508	0.463	0.422	0.386
11	0.896	0.804	0.722	0.650	0.585	0.527	0.475	0.429	0.388	0.350
12	0.887	0.788	0.701	0.625	0.557	0.497	0.444	0.397	0.356	0.319
13	0.879	0.773	0.681	0.601	0.530	0.469	0.415	0.368	0.326	0.290
14	0.870	0.758	0.661	0.577	0.505	0.442	0.388	0.340	0.299	0.263
15	0.861	0.743	0.642	0.555	0.481	0.417	0.362	0.315	0.275	0.239
16	0.853	0.728	0.623	0.534	0.458	0.394	0.339	0.292	0.252	0.218
17	0.844	0.714	0.605	0.513	0.436	0.371	0.317	0.270	0.231	0.198
18	0.836	0.700	0.587	0.494	0.416	0.350	0.296	0.250	0.212	0.180
19	0.828	0.686	0.570	0.475	0.396	0.331	0.277	0.232	0.194	0.164
20	0.820	0.673	0.554	0.456	0.377	0.312	0.258	0.215	0.178	0.149

Periods (n)	Interest rates (r)									
	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	0.812	0.797	0.783	0.769	0.756	0.743	0.731	0.718	0.706	0.694
3	0.731	0.712	0.693	0.675	0.658	0.641	0.624	0.609	0.593	0.579
4	0.659	0.636	0.613	0.592	0.572	0.552	0.534	0.516	0.499	0.482
5	0.593	0.567	0.543	0.519	0.497	0.476	0.456	0.437	0.419	0.402
6	0.535	0.507	0.480	0.456	0.432	0.410	0.390	0.370	0.352	0.335
7	0.482	0.452	0.425	0.400	0.376	0.354	0.333	0.314	0.296	0.279
8	0.434	0.404	0.376	0.351	0.327	0.305	0.285	0.266	0.249	0.233
9	0.391	0.361	0.333	0.308	0.284	0.263	0.243	0.225	0.209	0.194
10	0.352	0.322	0.295	0.270	0.247	0.227	0.208	0.191	0.176	0.162
11	0.317	0.287	0.261	0.237	0.215	0.195	0.178	0.162	0.148	0.135
12	0.286	0.257	0.231	0.208	0.187	0.168	0.152	0.137	0.124	0.112
13	0.258	0.229	0.204	0.182	0.163	0.145	0.130	0.116	0.104	0.093
14	0.232	0.205	0.181	0.160	0.141	0.125	0.111	0.099	0.088	0.078
15	0.209	0.183	0.160	0.140	0.123	0.108	0.095	0.084	0.079	0.065
16	0.188	0.163	0.141	0.123	0.107	0.093	0.081	0.071	0.062	0.054
17	0.170	0.146	0.125	0.108	0.093	0.080	0.069	0.060	0.052	0.045
18	0.153	0.130	0.111	0.095	0.081	0.069	0.059	0.051	0.044	0.038
19	0.138	0.116	0.098	0.083	0.070	0.060	0.051	0.043	0.037	0.031
20	0.124	0.104	0.087	0.073	0.061	0.051	0.043	0.037	0.031	0.026

Cumulative present value of \$1 per annum, Receivable or Payable at the end of each year for n years $\frac{1-(1+r)^{-n}}{r}$

Periods (n)	Interest rates (r)									
	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%
1	0.990	0.980	0.971	0.962	0.952	0.943	0.935	0.926	0.917	0.909
2	1.970	1.942	1.913	1.886	1.859	1.833	1.808	1.783	1.759	1.736
3	2.941	2.884	2.829	2.775	2.723	2.673	2.624	2.577	2.531	2.487
4	3.902	3.808	3.717	3.630	3.546	3.465	3.387	3.312	3.240	3.170
5	4.853	4.713	4.580	4.452	4.329	4.212	4.100	3.993	3.890	3.791
6	5.795	5.601	5.417	5.242	5.076	4.917	4.767	4.623	4.486	4.355
7	6.728	6.472	6.230	6.002	5.786	5.582	5.389	5.206	5.033	4.868
8	7.652	7.325	7.020	6.733	6.463	6.210	5.971	5.747	5.535	5.335
9	8.566	8.162	7.786	7.435	7.108	6.802	6.515	6.247	5.995	5.759
10	9.471	8.983	8.530	8.111	7.722	7.360	7.024	6.710	6.418	6.145
11	10.368	9.787	9.253	8.760	8.306	7.887	7.499	7.139	6.805	6.495
12	11.255	10.575	9.954	9.385	8.863	8.384	7.943	7.536	7.161	6.814
13	12.134	11.348	10.635	9.986	9.394	8.853	8.358	7.904	7.487	7.103
14	13.004	12.106	11.296	10.563	9.899	9.295	8.745	8.244	7.786	7.367
15	13.865	12.849	11.938	11.118	10.380	9.712	9.108	8.559	8.061	7.606
16	14.718	13.578	12.561	11.652	10.838	10.106	9.447	8.851	8.313	7.824
17	15.562	14.292	13.166	12.166	11.274	10.477	9.763	9.122	8.544	8.022
18	16.398	14.992	13.754	12.659	11.690	10.828	10.059	9.372	8.756	8.201
19	17.226	15.679	14.324	13.134	12.085	11.158	10.336	9.604	8.950	8.365
20	18.046	16.351	14.878	13.590	12.462	11.470	10.594	9.818	9.129	8.514

Periods (n)	Interest rates (r)									
	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%
1	0.901	0.893	0.885	0.877	0.870	0.862	0.855	0.847	0.840	0.833
2	1.713	1.690	1.668	1.647	1.626	1.605	1.585	1.566	1.547	1.528
3	2.444	2.402	2.361	2.322	2.283	2.246	2.210	2.174	2.140	2.106
4	3.102	3.037	2.974	2.914	2.855	2.798	2.743	2.690	2.639	2.589
5	3.696	3.605	3.517	3.433	3.352	3.274	3.199	3.127	3.058	2.991
6	4.231	4.111	3.998	3.889	3.784	3.685	3.589	3.498	3.410	3.326
7	4.712	4.564	4.423	4.288	4.160	4.039	3.922	3.812	3.706	3.605
8	5.146	4.968	4.799	4.639	4.487	4.344	4.207	4.078	3.954	3.837
9	5.537	5.328	5.132	4.946	4.772	4.607	4.451	4.303	4.163	4.031
10	5.889	5.650	5.426	5.216	5.019	4.833	4.659	4.494	4.339	4.192
11	6.207	5.938	5.687	5.453	5.234	5.029	4.836	4.656	4.486	4.327
12	6.492	6.194	5.918	5.660	5.421	5.197	4.988	4.793	4.611	4.439
13	6.750	6.424	6.122	5.842	5.583	5.342	5.118	4.910	4.715	4.533
14	6.982	6.628	6.302	6.002	5.724	5.468	5.229	5.008	4.802	4.611
15	7.191	6.811	6.462	6.142	5.847	5.575	5.324	5.092	4.876	4.675
16	7.379	6.974	6.604	6.265	5.954	5.668	5.405	5.162	4.938	4.730
17	7.549	7.120	6.729	6.373	6.047	5.749	5.475	5.222	4.990	4.775
18	7.702	7.250	6.840	6.467	6.128	5.818	5.534	5.273	5.033	4.812
19	7.839	7.366	6.938	6.550	6.198	5.877	5.584	5.316	5.070	4.843
20	7.963	7.469	7.025	6.623	6.259	5.929	5.628	5.353	5.101	4.870