INDIAN INSTITUTE OF MATERIALS MANAGEMENT

JUN-2010 **Post Graduate Diploma in Materials Management**

Paper 15

Strategic Cost and Financial Management

Date: 16.6.2010 **Max.Marks: 100**

Time: 2.00 pm to 5.00 pm **Duration: 3 Hours**

Instructions:

1. From Part-A answer all questions (compulsory). Each question carries 8 marks. **Total: 32 Marks.**
2. From Part B answer any 3 questions out of 5 questions. Each question carries 16 marks. **Total: 48 Marks.**
3. Part C is a case study (compulsory). Read the case carefully and answer the questions. **Total: 20 Marks.**

PART A

Q1.Choose the right answer from below:

1. Cash can be conserved by keeping:
   a) Maximum quantity of stock
   b) Minimum level of creditors
   c) Best credit terms with suppliers
   d) None of the above

2. Earning after interest and tax is Rs.40 crores. Interest is Rs. 8 crores and Income Tax is Rs. 32 crores. Interest coverage ratio will be:
   a) 09
   b) 10
   c) 05
   d) 07.50
3. A project is more acceptable to finance if its
   a) Break even point is high
   b) IRR is greater than cost of capital
   c) Neither a) nor b)
   d) Both A) and b)

4. A company manufacturing washing machines has an annual capacity of 5,000 units. Unit variable cost is Rs. 1600 and selling price is Rs. 2000. Annual fixed cost is Rs. 5,00,000. Its BEP in units will be :
   (a) 1000 (b) 1250 (c) 1200 (d) 900.

5. Which of the following is not a use of funds?
   a) Increase in fixed assets.
   b) Increase in accrued expenses.
   c) Payment of taxes.
   d) Decrease in provisions

6. For arriving at the book value of equity shares which of the following would you consider?
   a) Increase in market price per share.

b) Increase in share capital
c) Dividends paid
d) Networth

7. Current ratio can be improved by
   a) More bank borrowing for working capital
   b) Increase in credit sales
   c) Long term borrowing for investment in current assets
   d) Redemption of debentures

8. When the amount of under over absorbed overheads is significant, it should be disposed of by
   a) Transfer to costing profit and loss account
   b) Using a supplementary rate.
   c) Carry over to next year.
   d) None of the above.

Q2. State whether the following statements are 'True' or 'False':

1. At break even point, the firm earns only a marginal profit.
2. Abnormal loss or gain does not affect the cost of production in process costing.
3. Notional costs are recorded in the Cost Books.
4. NPV & IRR techniques recognize the risk element in capital budgeting.
5. A preference share is a hybrid security.
6. In the New Issues Market, only a new company can issue its securities.
7. Long term owned fund of the company is also known as long term debt.
8. $\frac{\text{Annual sales}}{\text{Net fixed assets}}$ = Total assets turn over ratio

Q3. Fill in the blanks:

1. -------------clause in a contract provides that the contract price would be enhanced on the happening of the specified contingency.
2. A statement which is classified into three main categories, namely, operating,----------- and financing is known as a Cash Flow statement.
3. The-------------- bears the risk of obsolescence under operating lease.
4. --------------is a market for short term securities such as Treasury Bills.
5. ---------------is calculated by dividing the Total Present Value of anticipated cash in flows by the initial outlay.
6. A --------------is incidental to the process of manufacturing the main product.
7. -------------- merger takes place when firms engaged at different stages of production or distribution of the same product come together.
8. Cost of the capital is the----rate of return expected by the investors.

Q4.Match the following:

1) Primary markets	a) Technique of capital budgeting based on accrued profits after tax
2) Factoring	b) An unsecured promissory note issued at discount.
3) Stock exchange	c) Responsibility fixation for costs incurred
4) Cost centre	d) Initial public offers of securities
5) Commercial paper	e) Purchase of book debts by a specialised agency

6) ARR	f) Cash flows from financing activities.
7) Modigliani-Miller	g) Trading in listed securities
8) Redemption of term loans	h) Financial leverage has no effect on overall cost of capital.

PART B

Answer any 3 questions:

Q5. A plastic manufacturing company is considering replacing an older machine which was fully depreciated for tax purposes with a new machine costing Rs.40,000. The new machine will be depreciated over its eight year life time to zero on a straight line basis. It is estimated that the new machine will reduce labour costs by Rs.8,000 per year. The management believes that there will be no change in other expenses and revenues of the firm due to the new machine. The company requires an after-tax return on investment of 10%. Its rate of tax is 35%. The company's income statement for the current year is given for other information. Should the company buy the new machine? P.V. of an annuity of Re.1 to be received over 8 years @ 10% p.a. = 5.3349 (as per annuity tables)

Income statement for the current year:

	Rs.	Rs.
Sales		5,00,000
Costs:		
Materials	1,50,000	
Labour	2,00,000	
Factory and admn. Overheads	40,000	
Depreciation	40,000	4,30,000
Net income before taxes		70,000
Less : Taxes @ 35%		24,500
Earnings after taxes		45,500

Q6. a) The following figures relate to two companies.

	A Ltd (Rs in lakhs)	B Ltd (Rs. In lakhs)
Sales	500	1000
Variable costs	200	300
Contribution	300	700
Fixed Costs	150	400
	150	300
Interest	50	100
Profit before Tax	100	200

You are required to

(i) Calculate the operating and financial leverages and

(ii) Comment on the relative risk position of the two companies

b) Explain the meaning of Trading on Equity.

c) Explain the concept of Breakeven rental

Q7. Write Short Notes on **any 4** from the following:

1) Weighted Average Cost of capital.
2) Pay back period method of capital budgeting
3) Limitations of ratio analysis.
4) Defects of profit maximization goal.
5) Types of financial analysis.
6) Functions of merchant bankers.
7) Factoring
8) Sources of credit information for evaluation of customers.

Q8.a) The following data have been extracted from the records of L Ltd. .

	(Rs. per unit)
Raw material	45
Direct labour	20
Overheads	40
	105
Profit	15
Selling price	120

Raw materials are in stock on an average for 2 months. Materials are in process on an average for 4 weeks. The degree of completion is 50% (applicable to materials, labour and overheads).

Finished goods are in stock on an average for 1 month.

Time lag in payment of wages and overheads is 1 ½ weeks.

Time lag in receipts of proceeds from debtors is 2 months.

Credit from suppliers is 1 month.

20% of output sold against cash.

The company expects to keep cash balance Rs.1 lac.

The company expects to produce 144,000 units in the year. 52 weeks p.a may be taken as the basis.

Prepare a statement of working capital needs

b) State the factors affecting the requirements of Working Capital.

Q9.a) Prepare a Cash Budget for the three months ended 30th September 2001 based on the following information:

	Rs.	
Cash at bank on 1st July 2001		25,000
Monthly estimated salaries and wages	10,000	
Interest payable in August 2001	5,000	

Details	**June**	**July**	**August**	**September**
	Actual			
Cash Sales	1,20,000	1,40,000	1,52,000	1,21,000
Credit sales	1,00,000	80,000	1,40,000	1,20,000
Purchases	1,60,000	1,70,000	2,40,000	1,80,000
Other expenses	18,000	20,000	22,000	21,000

Credit sales are collected 50% in the month of sale and 50% in the month following. Collections from credit sales are subject to 10% discount if received in the month of sale and to 5% if received in the month following.10% of the purchases are in cash and balance is paid in next month

b) State the methods of apportionment of Joint Costs to the Joint Products.

PART C (compulsory)

Q10. The following details have been extracted from the annual budget of Classic manufacturing Co. Ltd. for the year 2008-2009.

	Per Unit(Rs.)	**Per annum (Rs.)**
Selling Price	300	
Direct materials	64	
Direct labour	48	
Production Overheads		
-Variable	32	40,00,000
-Fixed		
Administration Overheads-Fixed		30,00,000
Selling and distribution Overheads		
-Variable	36	
-Fixed		20,00,000

Currently the company is operating on a margin of safety of 25%.To improve its profitability further, the company is considering the following options:

(1) Reduce selling price by 5%. Sales volume is expected to increase by 20%. Also fixed production overheads will increase by Rs.2 lakhs and fixed selling and distribution overheads by Rs.3 lakhs.

(2) Increase selling price by 5%. This will cause a drop in sales volume by 10%. To arrest further fall in sales, an increase of Rs. 2 lakhs will be required under fixed selling and distribution overheads.

(3) Production can be increased by 15% by introducing an incentive scheme for labour. This will increase direct labour cost by 25%. An addition expenditure of Rs. 3 lakhs would be required under fixed selling and distribution overhead to market the increased production.

Required:

(a) Current level of production/ sales and profit earned.

(b) Assuming that (1), (2) and (3) are mutually exclusive and other items remain unaffected, evaluate each of these options.

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