

FM & Eco. for finance		CA R. K. Mehta
Test – 1 (Solution)		
Time Allowed: 1 hour	19-Jan-2020	Total Marks :34 Marks

Answer to Question No.1

Treasurer Management: - It is generally believed that treasurer management means cash management but it is not completely true. Cash management is part of treasurer management.

Treasurer management includes :-

- Management of future receipts and payments so as to avoid the liquidity problems in the future.
- Management of foreign currencies in relation to import and export of goods.
- Preparation of cash budget of various departments of the organization during different periods.
- Maintaining good relations with the bankers.
- Deciding about the financial requirements of various projects to be initiated in the future.
- Ascertaining the best course of arrangement of funds which will involve minimum cost of capital.
- Making appropriate investments at correct timings for obtaining optimum rate of return.
- Also, making investment of surplus funds in marketable securities considering the factors of safety, maturity and marketability.

Answer to Question No.2

(1) Evaluation of the decision regarding engagement of factor :-

Saving in Bad Debts (1.5 % of Sales)	` 18,000
Saving in Administration expenses	` 50,000
	<u>` 68,000</u>
(-) Factor Commission (2 % of Sales)	(24,000)
Net Benefit	<u>` 44,000</u>

So, it is advised to avail the services of factor.

(2) Determination of % of cost of factor commission & interest in relation to the amount of advance:-

Debtors' Balance (90 days credit sales)	` 3,00,000
(-) 10% Reserve	(-) 30,000
	<u>` 2,70,000</u>
(-) Interest ($\text{` } 2,70,000 \times 16\% \times 90/360$)	(-) 10,800
(-) Factor commission (2 % of ` 3,00,000)	(-) 6,000
Advance given by the factor	<u>2,53,200</u>

Now, Interest and Factor Commission for 90 days = 10,800 + 6,000 = 16,800 and for 360 days = $16,800 \times \frac{360}{90} = \text{` } 67,200$

$$\% \text{ Cost} = \frac{\text{` } 67,200}{\text{` } 2,53,200} = 26.54\%$$

Answer to Question No.3

Particulars	1,00,000 units	1,20,000 units
Sales (@ ` 10)	10,00,000	12,00,000
(-) Variable Cost (@ ` 6)	(6,00,000)	(7,20,000)
Contribution	4,00,000	4,80,000
(-) Fixed Cost	(2,00,000)	(2,00,000)
EBIT	2,00,000	2,80,000
(-) Interest	(1,00,000)	(1,00,000)
EBIT	1,00,000	1,80,000
(-) Tax @ 50 %	(50,000)	(90,000)
EAT	50,000	90,000
No. of Equity Shares	10,000	10,000

EPS	` 5	` 9
(a) % increase in EPS		80%
(b) DFL (EBIT/EBT)	2	1.56
(c) DOL (c/EBIT)	2	1.71

In relation to increase in production from 1,00,000 units to 1,20,000 units, both the operating and financial leverages are reduced to a great extent thereby giving the message that the burden of fixed cost (business risk) and interest (financial risk) has been reduced.

Answer to Question No.4

Statement showing Working Capital Requirement

Particulars	Amount (`)
Stock of Raw Material	10,00,000
Stock of WIP	3,75,000
Stock of Finished Goods	10,00,000
Debtors	16,00,000
Cash in hand	25,000
Total Current Assets	40,00,000
Less: Creditors	5,00,000
Working Capital	35,00,000
Add : 20% Safety Margin	7,00,000
Sales	42,00,000

Note : 1 Computation of Cash Sales and Credit Sales

Assume Credit Sales = ` x
 Cash Sales = ` x less 75% = 0.25x.

Now,

Credit Sales + Cash Sales = Total Sales
 \Rightarrow Total Sales = ` x + ` 0.25x = 1.25x

It is observed that credit sale is 80% and cash sale is 20% of total sales.

Note : 2 (Monthly Statement)

Raw Materials (25,000 units x ` 20 / unit)	` 5,00,000
Labour Cost (25,000 units x ` 5 / unit)	` 1,25,000
Cash Factory OH (25,000 units x ` 15 / unit)	` 3,75,000
Cash Production Cost	` 10,00,000
Cash Administration Overheads	NIL
Cash Selling Overheads	NIL
Cash Total Cost	` 10,00,000
Depreciation (25,000 units x ` 5 / unit)	` 1,25,000
Total Cost	` 11,25,000
Profit	` 1,25,000
Sales (25,000 units x ` 50 / unit)	` 12,50,000

Note: 3 (Stock of Raw Material) : Since raw material holding period is 2 months, the stock of raw material is equal to 2 month's consumption, i.e. $2 \times 5,00,000 = ` 10,00,000$.

Note: 4 (Stock of WIP): We are given that WIP holding period is $\frac{1}{2}$ month. Assuming that material cost is 100% spent and labour and overheads are 50% spent, the stock of WIP is computed below :

Material (` 5,00,000 p.m. \times $\frac{1}{2}$ month \times 100%)	` 50,000
Wages (` 1,25,000 p.m. \times $\frac{1}{2}$ month \times 50%)	` 31,250
Cash Factory OH (` 3,75,000 p.m. \times $\frac{1}{2}$ month \times 50%)	` 93,750
	` 3,75,000

Note: 5 (Stock of Finished Goods): Since finished goods holding period is 1 month, the stock of finished goods is equal to 1 month cash production cost i.e. ` 10,00,000.

Note : 6 (Debtors): Since debtors collection period is 2 months, the investment is equal to 2 months cash total cost in context of credit sales, i.e. $(` 10,00,000 \text{ p.m.} \times 80 / 100) \times 2 \text{ months} = ` 16,00,000$

Note: 7 (Creditors): Since creditors' payment period is 1 month, the creditors balance is equal to 1 month credit purchases, i.e. ` 5,00,000.

