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[Finance](https://assignbuster.com/essay-subjects/finance/)

ACCOUNTING QUESTIONS ACCOUNTING QUESTIONS ANSWERS Task two Calculation of the cash flow for each ofthe five years
Annual cash flow
year 0
-100, 000
year 1
20, 000
year 2
40, 000
year 3
60, 000
year 4
60, 000
year 5
40, 000
Calculation of Cash Flows:
Sale price per unit=£ 12
Variable Cost per unit=£ 8
Contribution=£ 4
Cash flow of 1st Year=£ 4 \* 5, 000=£ 20, 000
Cash flow of 2nd Year=£ 4 \* 10, 000=£ 40, 000
Cash flow of 3rd Year=£ 4 \* 15, 000=£ 60, 000
Cash flow of 4th Year=£ 4 \* 15, 000=£ 60, 000
Cash flow of 5th Year=£ 4 \* 5, 000=£ 20, 000
In 5th year, there is termination value of machine which is £20, 000, therefore there is additional cash flow of £20, 000 during 5th year.
2. Using the investment appraisal methods to calculate the ARR, Payback, NPV and IRR
2. 1 Calculation of Accounting Rate of Return (ARR)
Accounting Rate of Return= Average Annual Cash Flow / Average Investment
=[£ 24, 000 / £ 60, 000] \*100
= 40%
Average Investment = Cost of Machine + Disposal Value / by two
Total Cash Flow during useful life of machine= £ 200, 000
Average annual cash flow = £ 200, 000 / 5
= £ 40, 000
Average Investment = £ 100, 000 + £20, 000/2
Average Investment = £ 60, 000
2. 2 Calculating the payback
Initial Investment
100, 000
Accumulative Cash Flow
Cash Flow Year 1
20, 000
20, 000
Cash Flow Year 2
40, 000
60, 000
Cash Flow Year 3
60, 000
120, 000
The Accumulative cash flow up to year 2 is £ 60, 000, initial investment required is £ 100, 000 thus cash flow required during year 2 is £ 40, 000. The cash flow during year 3 is £ 60, 000. Therefore calculation will be:
Cash flow required during year 3= £ 60, 000
Time required to generate required amount=£ 40, 000 / £ 60, 000
= 0. 67 years i. e. 8 months (0. 67 \* 12)
Therefore, the machine will take two years and 8 months to generate cash flow of amount equal to initial investment i. e. £ 100, 000.
2. 3 Calculating the NPV
Years
Net Cash Flows
PV
0
(100, 000)
1
20, 000
17, 860
2
40, 000
31, 880
3
60, 000
42, 720
4
60, 000
38, 160
5
40, 000
22, 680
Total
153, 3000
Sum of PV 1-5Yrs based on COC =£153, 3000
Initial Investment required to get machine operational =£100, 000
Net Present Value= £153, 3000 - £100, 000
=£ 53, 300
Therefore, the Net Present Value calculated is £ 53, 300, which is highly positive.
2. 4 Calculating the Internal Rate of Return:
Years
Net Cash Flows
0
(100, 000)
1
20, 000
2
40, 000
3
60, 000
4
60, 000
5
40, 000
The IRR calculated through MS Excel is 29. 16%. Calculations based on Trial & Error method is summarized as shown below
Years
Net Cash Flows
PV @ 25%
PV @ 30%
PV @ 28%
PV @ 29%
1
20, 000
16, 000
15, 385
15, 625
15, 504
2
40, 000
25, 600
23, 669
24, 414
24, 037
3
60, 000
30, 720
27, 310
28, 610
27, 950
4
60, 000
24, 576
21, 008
22, 352
21, 667
5
40, 000
13, 107
10, 773
11, 642
11, 197
Total
110, 003
98, 144
102, 643
100, 355
The table above is showing present value of estimated cash flows at different rates while it is clear that present value of estimate cash flows at 29 percent and 30 percent are respectively nearest greater and less to initial investment therefore the IRR will lie between 30% and 29%. Exact value will be calculated through interpolation, as below.
Present Value of Estimated Cash Flows @ 30%=£98, 144
Present Value of Estimated Cash Flows @ 29Nd%=£100, 355
Initial Investment =£100, 000
Internal Rate of Return = 29% + (100, 000 – 98, 144) / 100, 000
= 29% + 0. 1656
= 29. 165
Therefore, the IRR calculated through Trial & Error method is 29. 165% approximately at which the present value of estimated cash flows is £99, 996 which is approximately equal to initial investment i. e. £100, 000
3. Advising the client to either accept or reject the project
The customer should take the project because the payback period is two years and eight months, besides, the IRR calculated through Trial & Error method is 29. 165% approximately at which the present value of estimated cash flows is £99, 996 that gives an approximately equal to initial investment i. e. £100, 000.
Task three
1. Cash budget for the months of august to November 2014
Pedrosa Plc
Cash Budget
For the period from August 2014 to November 2014
Opening Cash Balance
August
Sep
Oct
Nov
15, 400
37, 240
43, 390
48, 930
Sales
67, 650
60, 400
58, 500
55, 500
Cash Sales
27, 060
24, 160
23, 400
22, 200
1 Month
39, 180
40, 590
36, 240
35, 100
Rent Income
9, 000
9, 000
9, 000
9, 000
Cash Receipt
75, 240
73, 750
68, 640
66, 300
Net Cash Inflow
90, 640
110, 990
112, 030
115, 230
Y
Purchases
33, 600
32, 600
34, 750
35, 650
Cash Payments
35, 400
33, 600
32, 600
34, 750
Wages
18, 000
18, 000
18, 000
19, 080
Dividend
16, 000

Machine

12, 500
6, 250
Cash Payments
53, 400
67, 600
63, 100
60, 080

Ending Cash Balance
37, 240
43, 390
48, 930
55, 150
The ending cash balance during month of August is £37, 240 while the expected cash balance during September is £43, 390. Similarly the expected cash balance during October and November are £48, 930 and £55, 150 respectively as shown in the table above.
2. Benefits of the budget to a business
Organisations need budget to help in the evaluation of its performance. Without a financial planning that makes use of the budget, they would not be in a position to assess their progress and institute appropriate measures. Besides, they need budgeting for efficient coordination of the organisational activities. The budget acts like a blueprint that provides the roadmap and the expectation of the activities like sales, expenditures, and other costs. When organisations do not use budgets to address these issues, they are at risk of running down the organisation because of unplanned activities that are likely to exceed the expectations. Budgeting helps organisations to take control of their finances, hence keeping focused on the goals they laid down when beginning the financial year. A budget helps the organisation plan savings and makes decisions in advance when expecting or not expecting any costs related to the activity of the organisation hence controlling debts (Young, 2003).
2. 1 What can be done to enhance budgeting process?
Budgeting process can be very challenging especially when there is poor communication between the team tasked with the making of decisions. Therefore, enhancing communication and reducing the number of people involved in the making of budget will help improve the process (Young, 2003). Besides, it is important to have time and iterate the budget because handling the process at the last minute may hamper the process. It is also crucial to have time to review and improve areas that may not represent the expectations of the organisation (Young, 2003).
BIBLIOGRAPHY
Young, R. D. (2003). Performance-Based Budget Systems - Public Policy & Practice, p. 12, available online from ww. iopa. sc. edu/ejournal/assets/performance%20based%20budgets. pdf [21st June 2015)