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ACCOUNTING QUESTIONS ACCOUNTING QUESTIONS ANSWERS Task two

Calculation of the cash flow for each of the 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](http://www.iopa.sc.edu/ejournal/assets/performance%20based%20budgets.pdf) [21st June 2015)